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Investment in Mexico: A Springboard toward the NAFTA Market - An Asian Perspective

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† The term "investment" indicates "direct investment."

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I. Introduction

On December 17, 1992, U.S. President Bush, Mexican President Salinas and Canadian Prime Minister Mulroney signed the North American Free Trade Agreement[1] (NAFTA) and, as expected, NAFTA was ratified by the three nations and went into force in January, 1994.[2] This agreement creates an enormous free trade area, with 360 million people and a total trade output of almost 6.5 trillion dollars in annual production.[3] NAFTA is

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[1] North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., Pub. L. No. 103-182, 107 Stat. 2057, *reprinted in* 32 I.L.M. 605 (1993) [hereinafter NAFTA].

[2] *Id.* art. 2203.

[3] U.S. CHAMBER OF COM., A GUIDE TO THE NORTH AMERICAN FREE TRADE AGREEMENT: IMPLICATION FOR U.S. BUSINESS xi (1992); *see also NAFTA Opens New Market for U.S. Accountants; North American Free Trade Agreement: Column,* ACCT.

expected to provide considerable free trade benefits for North American countries, particularly for Mexico, through trade creation and the resulting effect on consumer welfare. However, non-participating countries in Asia are likely to suffer economic hardships because of NAFTA's potential to divert trade away from Asian countries.

NAFTA's impact on Asia is particularly significant. From an economic perspective, Mexican goods will likely replace some labor-intensive Asian goods bound for the U. S. market due to the elimination of tariff and non-tariff barriers, and relatively inexpensive and abundant Mexican labor. In addition, NAFTA will also pose a strong threat to industries in the Asian Newly Industrialized countries (NICs) because many of them rely on the North American market as their major export destination. Many Asian NIC-made products will face strong competition from Mexican-made products in the U.S. market,[4] and the competition is expected to be fierce as soon as Mexico acquires enough foreign capital and advance technologies. Therefore, the impact of NAFTA seems by extension important to the overall Asian economy. Facing imminent adverse impact from NAFTA, Asian enterprises need to study investment feasibility in Mexico in order to maintain their competitiveness and secure access to the NAFTA market.

On the other hand, Mexico is undergoing a fundamental transformation in its economic strategy and its relations with the international community in order to revive itself from the debt

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TODAY, Oct. 10, 1994, *available in* LEXIS, World Library, Allwld File.

[4] Anna Taing, *Malaysia: East Asia Faces Big NAFTA Challenge—Lehmans*, BUS. TIMES, Dec. 15, 1993, *available in* LEXIS, World Library, Txtfe File. According to a report unveiled by Lehman Brothers, facing the impact of NAFTA, Asian "new" NICs, Malaysia, China, Indonesia, the Philippines and Thailand, may be more vulnerable in the long run, because of their growing dependence on the North American market. *Id.* On the other hand, Hong Kong, Singapore, South Korea and Taiwan will experience greater trade diversion in the short term. *Id.* In addition, a study made by U.S. DRI/McGraw-Hill consulting firm also forecasted that competition from Mexico would cut Taiwan's exports to the U.S. by US$ 4.4 billion between 1994 and 2000 as a result of NAFTA. *See* DRI/MCGRAW-HILL, THE IMPACT OF THE NORTH AMERICAN FREE TRADE AGREEMENT ON INDUSTRIES IN THE REPUBLIC OF CHINA ON TAIWAN 2 (1993). Moreover, Korean studies also suggest that their exports, such as computers, textiles, automotive products, and consumer electrical equipment, in the U.S. market will face strong competition from Mexican made ones. Lee Hang-koo, *South Korea: The Impact of North America Free Trade Agreement on Korean Industries*, KOREA ECON. DAILY, Apr. 1, 1992, *available in* LEXIS, World Library, Txtfe File.

crisis of the 1980s.[5] One important task in Mexico's economic reforms is to encourage foreign investors to participate in its economic revitalization.[6] Because a deregulated and liberalized legal framework can pave the way for foreign investors to participate in Mexico's economy, the Mexican government made a structural improvement in its foreign investment regime.[7] Mexico's efforts in its reforms combined with the establishment of NAFTA indeed create a favorable climate for attracting foreign investments.

The purpose of this article is to examine the feasibility with which Asian enterprises might strengthen their competitiveness in the NAFTA market by investing in Mexico. To serve this purpose, part II will give Asian investors a brief picture of Mexico's structural reforms in its economy as well as the potential pitfalls causing investment difficulties in this country. Part III will layout the improvement of legal framework in Mexico's foreign investment regime. The functions and benefits of Mexico in the NAFTA and potential Western Hemisphere market will be described in part IV. Recommendations and strategies in the potential sectors for Asian enterprise to access the NAFTA market through Mexico will be explored in part V. Finally, this paper concludes that Asian investors should view Mexico not only as their North America production base but also as a regional hub of the Western Hemisphere.

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[5] U.S.I.T.C., The Likely Impact on The United States of A Free Trade Agreement with Mexico, 1-1 (1991) [hereinafter U.S.I.T.C. Likely Impact]. The traditional perception of Mexico is that of a protective and closed economy, which is reinforced by its self-sufficiency and substantial government economic intervention policies. *Id.* Like many Latin American countries, Mexico adopted import-substitution policies, restrictions on foreign investment, and control of exchange rates to sustain its domestic economic growth and to avoid foreign domination of its economy. *Id.* Mexico relied heavily on its abundance of oil resources to obtain numerous foreign loans to finance its high consumer spending levels and unproductive investments. *Id.* However, the collapse of oil prices followed by high international interest rates in the early 1980s led Mexico into an economic crisis. *Id.* Massive foreign debts and hyperinflation caused a large amount of capital outflow that further crushed this country's economy into irreversible decay. *Id.*

[6] PHILIP RUSSELL, MEXICO UNDER SALINAS 219-20, 223 (1994).

[7] *See infra* notes 126-64 and accompanying text.

II. Mexico: A Country in the Process of Revival

A. Macroeconomic Adjustments

Mexico has endured the pain and risk of transforming its political and economic system into a moderate free-market system. After its economic crisis in the 1980s,[8] the Mexican government moved to change what had been a highly protected and over-regulated state controlled economy into one substantially more open to trade, private foreign and domestic investment.[9] Its reform strategy was to first use governmental intervention to regulate certain economic disorders. As such reforms gained momentum and political support, the Mexican government then gradually increased the role of the market oriented system.

1. Inflation

To foster a favorable investment environment and make the Mexican economy less vulnerable, it was crucial to reduce Mexico's inflation. The Mexican government utilized several inflation control mechanisms, which included the annual enactment of a price and wage freezing pact,[10] the autonomy of the Mexican central bank,[11] and debt reduction.[12] The outcome of

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[8] *See supra* note 5.

[9] JAN FEDOROWICZ ET AL., BUS. MEX. 9-10, 21-42 (1994).

[10] Martin Langfield, *Mexico Economic Pact Seen Renewed in October*, REUTERS, Sept. 1, 1994, *available in* LEXIS, World Library, Txtcsa File. The economic pact, known as PECE, is an agreement involving all sectors of the Mexican economy in a coordinated mechanism to establish limits on prices, wages, taxes, currency and government spending. *Id.* However, PECE has also been criticized for its side effects. Critics frequently cited milk production as an example. RUSSELL, *supra* note 6, at 185. Between December 1988 and May 1990, the prices for cattle feed grains such as cotton-seed hull, alfalfa, and sorghum, were allowed to increase by more than 100 percent. *Id.* Nevertheless, milk prices were only allowed by the participants to increase by 44 percent. *Id.* Therefore, many Mexican dairy farms were not willing to devote their efforts to milk production. *Id.* As a result, Mexico had to import milk from the U.S. at a price higher than those of domestic producers in previous years. *Id.*

[11] Roberto Galvan Gonzalez, *Bank of Mexico Reorganization, Central Bank Spin-off*, BUS. MEX., June 1994, at 18. On April 1, 1994, the Mexican Legislature amended Article 28 of the Mexican Constitution to grant autonomy to its central bank, Bank of Mexico. *Id.* The independence of Bank of Mexico is designed to avoid Mexico's previous mistake, which allowed other government authorities to finance public spending by petitioning the central bank for unsecured loans. *Id.* The unsecured loans unavoidably caused Bank of Mexico to increase the money supply and thereby increased inflation rates. *Id.*

implementing these economic adjustments is impressive, and it has significantly brought down inflation from a record high of 159 percent in 1987 to 7.1 percent in 1994.[13]

2. *Trade Liberalization*

Mexico has instituted numerous trade reforms in order to increase its international competitiveness after the failure of the import substitution policy in the early 1980s.[14] These reforms produced tremendous initiatives through bilateral and multilateral agreements. In particular, through its 1986 accession to full membership in the General Agreement of Trade and Tariff (GATT), Mexico has clearly proclaimed an intention to conform its trade laws and policies to world standards.[15] As part of its obligations under GATT, Mexico has significantly reformed its tariff structure to enable the Mexican market to be more accessible.[16] In addition, Mexico has also gradually eliminated many of its non-tariff barriers, such as official prices, import permits, and quantitative controls.[17] Today, the average import tariff rate is close to 10 percent with a maximum rate of 20 percent, and less than 2 percent of all imports are subject to quantitative restrictions.[18] Trade reforms make the Mexican

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[12] FEDOROWICZ ET AL., *supra* note 9, at 17-18. The Mexican government understood that, if the problem of debt was not solved, any attempts to stabilize its inflation would not succeed in the long run. *Id.* Therefore, debt reduction has represented a key priority for the Mexican government in its economic reforms. *Id.* Through a successful debt restructure negotiation with its creditors in 1990, the Mexican government has significantly strengthened its financial leverage to manage its debt reduction. *See* Banco DE MEXICO, THE MEXICAN ECONOMY 1994, 275 (1994), Table 61: Total External Debt. The outcome has been impressive because by 1993, Mexico's foreign debt was reduced to 36.1% of its GDP, down from 59% in 1988. *Id.*

[13] BANCO DE MEXICO, THE MEXICAN ECONOMY 1995, at 228 (1995).

[14] U.S.I.T.C., Likely Impact, *supra* note 5, at 1-2. The trade reforms were initiated by President de las Madrid and sought to eliminate tariff and non-tariff barriers to trade with Mexico. *Id.*

[15] E. PETERS & K. S. KIM, FROM TRADE LIBERALIZATION TO ECONOMIC INTEGRATION: THE CASE OF MEXICO 13 (1993).

[16] FEDOROWICZ ET AL., *supra* note 9, at 23.

[17] U.S.I.T.C., Likely Impact, *supra* note 5, at 1-2.

[18] *Economic Comparisons of Mexico, Canada, and the United States: Implications for the NAFTA*, MEXI. TRADE & L. REP., Oct. 1, 1993, *available in* LEXIS, World Library, Mtlr File [hereinafter *Economic Comparisons*]; *see also Country Report—Mexico*, WALDEN COUNTRY PROFILE, Feb. 17, 1993, *available in* LEXIS, World Library, Courep File.

market more accessible to foreign imports and improve Mexico's resource allocation. Hence, these reform efforts have finally come to fruition. Mexico's economy has gradually recovered and become the tenth largest in the world.[19] This recovery has also led it to a partnership in what will be the world's premier economic alliance, NAFTA.

3. Peso Crisis

Nevertheless, the recent crisis caused by the sharp devaluation of the Mexican peso has not only astonished foreign investors but has also revealed some of the economic flaws in Mexico's newly liberalized economy. A careful analysis of these economic pitfalls and their causes would be helpful for investors making decisions about their projects.

On December 20, 1994, the Mexican government announced that it could no longer support a fixed exchange rate and decided to devalue the peso.[20] The announcement of the devaluation policy by the Zedillo administration caused investors who received the information to respond with panic sales of the peso, and thus, to withdraw nearly $13 billion within a day.[21] This enormous amount of capital outflow immediately drained Mexico's meager international reserves, and forced the Mexican government to float the peso on the following day.[22] The confidence of investors in the peso was shattered and this led to a financial crisis in Mexico.

What made the Mexican government so vulnerable in dealing with the peso crisis can be attributed to the size of its current account deficits. The economic reforms have made business investments in Mexico particularly prosperous, thereby increasing overall Mexican spending.[23] The optimism of NAFTA increased

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[19] BANCO DE MEXICO, *supra* note 13, at 41. The rank is based on its GDP, which is measured by the purchasing power of its own currency in the domestic market. *Id.* In addition, it is the fifteenth largest economy in the world if its GDP is converted into dollars at the market rate. *Id.*

[20] Henry Tricks, *Mexico: Mexico Devaluate Peso as Chiapas Whips Markets*, REUTERS, Dec. 20, 1994, *available in* LEXIS, World Library, Txtcsa File.

[21] Anthony DePalma, *Salinas Blames Successor for Peso Crisis*, N.Y. TIMES, Mar. 2, 1995, at D1.

[22] *Id.*

[23] *See* Martin Feldstein, *The Right Policy for Mexico and the U.S.*, WALL ST. J., Feb. 1, 1995, at A12.

Mexican investment in plants and equipment. This investment substantially exceeded the amount that Mexicans themselves save,[24] and thus accelerated Mexico's current account deficit to $25 billion in 1992 and $23 billion in 1993.[25] In 1994, Mexico's current deficit reached $26.4 billion, which is close to 8 percent of its GNP, a ratio higher than international standards.[26] This deficit resulted in Mexico spending around $2.2 billion more in goods and services per month than it was earning from abroad per month in 1994.[27] To finance the investment-savings gap, Mexico inevitably had to depend on capital inflows from abroad.[28] The cooling of the international financial market in Mexico[29] led to a dependence on costly short-term financial liquid capitals and its foreign reserves to cover the current account deficit.[30]

The problem of capital inflows became imminent in 1994 when political turmoil in 1994 shook the confidence of investors and further increased the reluctance of investors to keep their

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[24] *Mexico: Finance Secretary Addresses Deputies on Economic Situation, Measures*, BBC MONITORING SERV.-LATIN AM., Jan. 26, 1995, *available in* LEXIS, World Library, Txtcsa File. The current proportion of Mexican savings in relation to Mexico's GNP dropped from the historically high level of more than 20 percent to levels close to 15 percent. *Id.* This level is relatively lower than other developed countries and Southeast Asian countries, which achieve savings levels in some cases as high as 30 percent. *Id.*

[25] *President Zedillo Address the Nation: Announces Emergency Measures*, BBC MONITORING SERV.-LATIN AM., Jan. 3, 1995, *available in* LEXIS, World Library Txtcsa File.

[26] Stephen Fidler, *That Sinking Feeling: Mexico's Currency Crisis Has Weakened President Zedillo's Government, Says Stephen Fidler*, FIN. TIMES, Jan. 2, 1995, at 12. *See also Mexico: Finance Secretary Addresses Deputies, supra* note 24.

[27] Fidler, *That Sinking Feeling, supra* note 26, at 12.

[28] *Id.*; *see also* Tim Golden, *Mexico's New Leader Finds Job Full of Painful Surprises*, N.Y. TIMES, Mar. 14, 1995, at A1.

[29] Fidler, *That Sinking Feeling, supra* note 26. The successive rises in U.S. interest rates from February, 1994, and sharp increase of the value of the Japanese yen made Mexico and other emerging markets become less attractive in the international financial market. *Id.*

[30] *See Id.*; Tim Golden, *supra* note 28. The Mexican government issues two short-term, 28-day, financial instruments to finance its current account deficit. *Mexico: Central Bank Measures to Overcome Financial Uncertainties*, BBC MONITORING SERV.: LATIN AM., Feb. 23, 1995, *available in* LEXIS, World Library, Allwld File. These two instruments are Cetes (Treasury Certificates) and Tesobonos (Treasury Bonds). *Id.* Financial liquid capitals is also called current capitals. For further discussion of financial liquid capitals see R. CHARLES MOYER ET AL., CONTEMPORARY FINANCIAL MANAGEMENT 626-64 (1990).

funds in Mexico.[31] Since then, Mexico's foreign exchange reserves have been declining dramatically.[32] To respond to the increasing size of the current account deficit and the decreasing inflow of capital that made Mexico's economy highly vulnerable, the Mexican government decided to devaluate the peso to adjust to the current account deficits.[33] The theory behind the Zedillo administration's strategy is that "devaluation will decrease imports of merchandise and services by making them more expensive."[34] In addition, the depreciation of the peso will make Mexican products cheaper and more attractive abroad, and thereby increase Mexico's exports.[35] Through the reduction in imports and increase in exports, Mexico can gradually increase its foreign exchange reserve and balance its current account. Therefore, Mexican authorities decided to impose a 15 percent devaluation on the peso, hoping that an exchange rate of 4.5 pesos to the dollar would be suitable for its economic situation.[36]

Nevertheless, it seems that the Mexican government was too optimistic about its strategy and underestimated the side-effects of the devaluation. Devaluation can cause temporary inflationary effects and can also harm prices in the local currency of imported products.[37] In addition, the depreciation of the peso is also risky to Mexico because it would inspire temporary crises of confidence.[38] For example, devaluation of the peso also abolishes Mexico's long defended exchange rate policy, which only allows for a

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[31] *Another Day, Another Dive*, ECONOMIST, Oct. 28, 1995, at 5. The political turmoil in Mexico included the Chiapas insurgency, the assassination of the PRI's original presidential candidate, Lius Donaldo Colosio, and formal secretary general of the PRI, Jose Francisco Massieu. *Id.*

[32] Robert L. Bartley, *Mexico: Suffering the Conventional Wisdom*, WALL ST. J., Feb. 8, 1995, at A14. According to a report from Bank of Mexico, Mexico's foreign reserves were at $30 billion before the assassination of former presidential candidate, Mr. Colosio, in March, 1994. *Id.* After the assasination the foreign reserve fell to about $12 billion at the time of President Zedillo's inauguration on December 1, 1994. *Id.*

[33] *Id.*

[34] *President Zedillo Address the Nation*, *supra* note 25.

[35] *Id.*

[36] DePalma, *Salinas Blames Successor for Peso Crisis*, *supra* note 21.

[37] *President Zedillo Address the Nation*, *supra* note 25.

[38] Bartley, *supra* note 32; *see also* Jeff Franks, Mexico: *Mexico Government Brings on Crisis of Confidence*, REUTERS-CENT. & S. AM., Dec. 22, 1994, *available in* LEXIS, World Library, Txtcsa File.

maximum annual depreciation of 4 percent for the peso.[39] The Mexican government's initial plan did not inspire confidence in the markets. Investors responded to the devaluation with panic sales of the peso and immediately drained out Mexico's foreign exchange reserves. This situation, thus, forced Mexico to give up its original plan and freely float the peso in the market. Since then, Mexico's economy has seemed fragile because it has had a collapsing currency, which usually indicates an inflationary spiral and an uncontrolled fiscal deficit in the economy.[40] Fortunately, because of the recent announcement of U.S.-led $52 billion guarantee loans to Mexico, the peso has gradually recovered.[41]

From an economic perspective, there is a simple way to deal with this currency crisis. The Mexican government could tighten its monetary policy and fiscal budget. These economic adjustments are intended to reduce its supply of pesos and government expenditures. Restricting the supply of pesos relative to the supply of dollars would increase the value of the peso, and thereby reduce the incentive for investors to cash pesos for dollars.[42] The decrease of government spending can also improve Mexico's current account deficits. Even though reducing the supply of pesos would also be likely to push up short-term interest rates, this would only be a side-effect, and long-term rates may actually benefit.[43]

The U.S-led international aid is following such a model and intends to cure Mexico's fundamental economic flaws. The rescue package offered to the Mexican government has stringent financial requirements,[44] which include provisions that Mexico run a budget surplus in 1995 and shrink its money supply through charging

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[39] *See* Fidler, *supra* note 26. The original Mexico exchange rate policy only allowed for a maximum 4 percent annual depreciation of the Mexican peso. *Id.*

[40] Bartley, *supra* note 32.

[41] Anthony DePalma, *U.S. Aid Plan Is Hardly A Cure-All*, N.Y. TIMES, Feb. 23, 1995, at D5. The U.S. led aid includes $20 billion from the United States, $17.8 billion from the International Monetary Fund, $10 billion from major European nations, $3 billion from commercial banks, and $1 billion from Canada and a group of South American Countries. *Id.*

[42] Bartley, *supra* note 32.

[43] *Id.*

[44] David E. Sanger, *Peso Rescue Sets New Limits on Mexico*, N.Y. TIMES, Feb. 22, 1995, at A1.

interest rates above the soaring rate of inflation.[45] Although some Mexicans have criticized that the restrictions imposed by the rescue package have undermined Mexico's sovereignty,[46] agreement to the aid is still the right path for Mexico. Without international loans, Mexico might be forced to impose a moratorium on debt repayment as it did in the early 1980s, and thereby to cause a deep recession in its economy.[47] Such a recession could potentially bring about an uncertain political climate in which the anti-market forces of the left could win the next presidential election or even use violence to seize power.[48] The international aid provides an escape from all of these potential uncertainties. In addition, the agreement imposes only those restrictions that are needed to stabilize the peso and economy.[49] In fact, the Zedillo administration may have to adopt monetary and fiscal restrictions beyond the requirements from the agreement, since there exists no better choice for Mexico.[50] By accepting the agreement, Mexico can use the rescue fund to strengthen its financial leverage and retire most of its costly short-term government bonds, tesobonos, and convert to cheaper long-term debts.[51] If it makes use of the rescue fund, Mexico might restore its credibility to investors soon.

On the other hand, it is certain that the path of economic adjustments will be painful for Mexicans, at least in the near future. For example, Mexico's economy is expected to have negative growth this year. In addition, government taxes and public utilities rates will increase in the near future,[52] and interest

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[45] *Id.*

[46] Many Mexicans accuse President Zedillo of yielding Mexico's sovereignty to the U.S. because the severe monetary and fiscal restrictions imposed by the loans mean an unprecedented degree of control over the management of Mexico's economy. Anthony de Palma, *Sense of Dollar Duress: with Deeper Pain Ahead, Many Mexicans Accuse President of Yielding Sovereignty*, N.Y. TIMES, Feb. 22, 1995, at A1.

[47] Feldstein, *supra* note 23.

[48] *Id.*

[49] Sanger, *supra* note 44.

[50] *See* DePalma, *Sense of Dollar Duress*, *supra* note 46.

[51] *Id.* at D6.

[52] *Mexico: Zedillo Says Economy to Improve in Late 1995*, REUTERS-CENT. & S. AM., Mar. 13, 1995, *available in* LEXIS, World Library, Txtcsa File. The Mexican government has increased its gasoline price by 35 percent and by 20 percent in

rates will remain at historically high levels to restrain the inflationary spiral and stabilize the exchange rate.[53] The high interest rates will have a strong adverse impact on economic activities.[54] Small and mid-sized companies would experience the strongest impact because the costly financing will force them into insolvency, and thus, unemployment is going to be severe.[55] Even though the effects of these economic adjustments make Mexico's prospects for short term economic development dim,[56] Mexico is still far better off than its was 10 years ago, before it began its economic reforms. In addition, Mexico's economic turmoil will eventually subside because its strong export performance arising from the peso's devaluation is likely to pave the way to the revival of its economy.[57]

The peso crisis has indeed damaged Mexico's investment climate,[58] and the uncertainty of Mexico's economic future is

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electricity charges. In addition, value-added tax also has been raised from 10 percent to 15 percent in the first quarter of 1995. *Id.* Moreover, the Mexican government will continue to increase the gasoline and electricity prices based on its newly renewed 1995 anti-inflation economic pact. David Luhnow, *Mexico: Mexican Stocks, Peso Surge on Economic Pact*, REUTERS, Oct. 31 1995, *available in* LEXIS, World Library, Txtcsa File.

53 Mexico's central bank has already raised high short-term interest rates from 40 percent to 50 percent in some government debts. Anthony DePalma, *Rates Up Sharply In Mexico*, N.Y. TIMES, Feb. 21, 1995, at D1.

54 Geri Smith et al., *Mexico: A Rough Road Back*, BUS. WK., Nov. 13, 1995, at 104, 106.

55 *Id.* at 107. There are a million Mexicans who have lost their job since the crisis. *Id.* at 105.

56 According to Mexican Finance Secretary Mr. Guillermo Ortiz, Mexico's economy is expected to decline by 1 percent in GDP in this year due to the currency crisis. Peter Truell, *Big Investor Relations Task: Selling Mexico to Wall St.*, N.Y. TIMES, Mar. 15, 1995, at D7. However, the Economic Intelligent Unit expected that a 3.5% decline in Mexico's GDP will be recorded in 1995. ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: MEXICO 4 (3rd quarter, 1995).

57 ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: MEXICO 4-5, 20 (3rd Quarter 1995). The devalued Mexican peso has significantly boosted Mexico's exports. *Id.* From January to May, 1995, Mexico's exports grew by 32 percent to U.S.$ 31.1 billion over 1994 levels. *Id.* at 20. Therefore, EIU forecast that Mexico will have a 1% growth in 1996 due to its export performance. *Id.* at 5.

58 *See* Richard Lacayo, *The Plunger: The Peso Heads South*, TIME, Jan. 9, 1995, at 44. Several instances point to a deteriorating investment climate. For instance, Mexico may have lost 12% of its total foreign investment in the beginning of the peso crisis, which indicates the lack of confidence in Mexico's investment climate by foreign investors. *Id.* In addition, automobile sales have significantly plunged by more than 50 percent since the peso crisis, another negative sign to foreign investment. DePalma, *Sense of Dollar Duress*, *supra* note 46.

likely to have a strong impact on investors involved in portfolio investment in the Mexican financial market. However, the sharp devaluation in the Mexican peso is not likely to be a negative, but rather a positive influence on those investors involved in direct investment related to export-oriented production.[59] After the peso crisis, Mexican companies are eager to establish partnerships more than ever before and Mexican assets are attractively priced for foreigners to establish a presence in Mexico.[60] For example, the price of real estate and labor wages in dollar terms has been reduced by more than 40 percent than what they were in December 1994.[61] The devaluated Mexican peso converts to cheap production costs in Mexico and enables Mexican products to become more competitive in the international market.[62] Thus, if investors can refrain from precipitous pessimism, they will find that opportunities still abound in Mexico.

B. Political Reform

In addition to its economic adjustments, Mexico is striving to change its political system because political reform is a sine qua non for quick economic recovery. Market oriented reformists have a strong political leader in the country. President Zedillo successfully took the office on December 1, 1994.[63] The new Mexican government has "pledged to deepen the free-market economic reforms, reconstruct the corrupt judicial system, and pursue greater democracy."[64] These pledges send a clear message

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59 Lacayo, *supra* note 58, at 47.

60 *Prognoses & Pondering, Latest Economic Forecasts by Experts*, BUS. MEX., Mar. 1995, at 27, 29.

61 Bartley, *supra* note 32, at A14. The exchange rate of peso once had 45 percent of devaluation in the market. *Id.*

62 Lacayo, *supra* note 58, at 47.

63 Anthony DePalma, *Ruling Party's Candidate Wins Presidency in Mexico, But Opposition Makes Gains.*, N.Y. TIMES, Aug. 23, 1994, at A1. On August 21, 1994, Mexican voters decided to continue the PRI's ruling of Mexico and chose Mr. Ernesto Zedillo Ponce de Leon as their new President. *Id.* Mr. Zedillo is a Yale-trained economist and serves as a career technocrat with no real political experience in Mexico. Geri Smith, *Mexico: Will Economic Reform Survive the Turmoil?*, BUS. WK., Aug. 22, 1994, at 41. He was unexpectedly chosen by President Salinas to run for the presidential campaign to replace the assassinated candidate Luis Donaldo Colosio in March, 1994. DePalma, *Ruling Party's Candidate Wins Presidency in Mexico, supra*, at A8.

64 Martin Langfield, *Mexico: New Mexican President Takes Office Pledging*

to investors that the path for foreigners doing business or investing would become more clear and accessible because the country would be run more by laws and regulations rather than by secret personal relationships.

However, these changes, especially new moves towards internal democracy within the ruling party, Institutional Revolutionary Party (PRI),[65] have caused agitation and resistance among the so-called "dinosaurs" of the anti-reform old guards in the PRI.[66] This resistance is expected because the reforms will take away many traditional mechanisms of political control from PRI. This resistance would also provoke a power battle between different interest groups in the country, as they simultaneously resist the reforms and seek to take the advantage of the reforms under way. In addition, President Zedillo is truly a freshman in Mexico's political platform. The Mexican people were not familiar with him until he became the PRI's presidential candidate.[67] President Zedillo's lack of a political background is seen as a weakness and thus hinders the PRI and civilian support of his political changes.[68]

In addition, President Zedillo has proposed that the PRI should be independent from the government, and distances himself from the running of the PRI.[69] This proposal shows Zedillo's intention

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Reform, REUTERS-CENT. & S. AM., Dec. 1, 1994, *available in* LEXIS, World Library, Txtcsa File; *see also Mexico: President Zedillo Gives Constitution Day Speech, Call for A "New Democracy,"* BBC MONITORING SERV.: LATIN AM., Feb. 9, 1995, *available in* LEXIS, World Library, Txtcsa File.

65 The Institutional Revolutionary Party has controlled the Mexican government for more than six decades and has had strong influence in Mexican government. ANITA WINSOR, THE COMPLETE GUIDE TO DOING BUSINESS IN MEXICO 4 (1994); *see also Mexico Will Economic Reform Survive the Turmoil?*, BUS. WK., Apr. 11, 1994, at 24.

66 ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: MEXICO 9 (4th quarter 1994).

67 President Zedillo did not have any experience in elected office before he became Mexican president. John Bailey, *Mexico's Moment*, N.Y. TIMES, Nov. 30, 1994, at A23. He has never held significant positions in his party, even though he has been a member since 1971. *See* IBC, INTERNATIONAL COUNTRY RISK GUIDE—MEXICO, Apr. 1994, *available in* LEXIS, World Library, IBCCRG File.

68 The unpopularity of President Zedillo can be seen in a telephone poll conducted by Time and CNN in February 1995. George J. Church, *Mexico's Troubles Are Our Troubles*, TIME, Mar. 6, 1995, at 38-39. The poll shows that as many as 35 percent Mexican people have an unfavorable impression of President Zedillo. *Id.*

69 ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: MEXICO 9 (4th quarter 1994); *see also* Tim Golden, *Mexican, Taking Office, Pledges to Fight Poverty and*

to reduce PRI's influence on government officials and disassociate the president from the PRI scandals.[70] Nevertheless, such an intention would put the party at odds with itself and thereby make party members less loyal to the sitting president and his policies than in the past.[71] This situation will inevitably undermine the president's ability to control events and prevent political upheavals. As a result, this development could lead to political volatility in Mexico, and thus, damage its investment climate.

The resistance to political reforms would provide little hope for the Zedillo administration to run the country smoothly. Nevertheless, foreign investors should realize that such political volatility is likely to exist in a young democratized country. The set principles and direction for Mexico are not likely to be changed. As the political climate becomes more clear, Mexico will be ruled more by laws and institutions, and become more stable for foreign investments.

C. The Challenges of Cross Cultural Labor Management

Cheap and abundant labor resources are the most often cited competitive advantage of Mexican manufacturing.[72] There are, however problematic issues behind this advantage, which some foreign plant managers repeatedly refer to as "people problems" and which they consider the most troublesome aspect about investing in Mexico.[73] Indeed, cheap Mexican labor is noted often by foreign investors for its poor work quality and low productivity.[74] Particularly, worker's productivity and product quality represent the critical successful factors in a product's competitiveness, in addition to a low wage rate.[75] Therefore, overcoming productivity and quality problems in the Mexican workforce is a critical challenge for investors' success in Mexico.

Corruption., N.Y. TIMES, Dec. 2, 1994, at A1, A11.

[70] ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: MEXICO 9 (4th quarter 1994).

[71] *Id.*

[72] Mary B. Teagarden et al., *Mexico's Maquiladora Industry: Where Strategic Human Resource Management Makes A Difference; Offshore Manufacturing Sites*, ORGANIZATIONAL DYNAMICS, Winter 1992, at 34, 40.

[73] *Id.* at 41.

[74] *Id.*

[75] *Id.*

Several factors present challenges for labor management in Mexico.[76] First, the shortage of skilled labor and managers is the major operating problem for investors' Mexican operations.[77] Mexico suffers from a shortage of highly skilled technician and middle- and upper-level managers.[78] This shortage has contributed to high turnover among these skilled managers because they are constantly leaving for better salaries.[79] Although investors can recruit trained personnel through several recruiting services, they often have to offer higher salaries and advancement because the demand for them is great.[80] As a result, the cost for employing middle- and upper-level managers and skilled technicians in Mexico can be equal or higher than for their counterparts in the U.S.[81]

Second, high employee absenteeism and turnover permeate foreign plants, particularly the maquiladoras.[82] In some maquiladoras, absenteeism is as high as 20 percent or more daily, and turnover ranges from 10 percent to 20 percent a month.[83] The high turnover and absenteeism are reflected in low productivity and low quality outputs, and they also become the main obstacle for investors to effectively implement their manufacturing strategies.[84] These problems are largely "due to the migrating

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[76] *See infra* notes 77-101 and accompanying text.

[77] WINSOR, *supra* note 65, at 90; ECONOMIST INTELLIGENCE UNIT, *Mexico, 10.00 Human Resource—10.01 Overview*, INVESTING LICENSING & TRADING, Sept. 1, 1995, *available in* LEXIS, World Library Inlitr File.

[78] WINSOR, *supra* note 65, at 90.

[79] *Id.*

[80] These recruiting services can be obtained from unions, employment agencies, and industrial chambers and association, such as American Chamber of Commerce in Mexico. *See* ECONOMIST INTELLIGENCE UNIT, *Mexico, 10.00 Human Resource—10.01 Overview*, INVESTING LICENSING & TRADING, Sept. 1, 1995, *available in* LEXIS, World Library Inlitr File.

[81] WINSOR, *supra* note 65, at 90.

[82] For further discussion of Maquiliadoras see *infra* notes 214-49 and accompanying text.

[83] *Mexico's Maquiladora Industry*, MEX. TRADE & LAW RPTR., Apr. 1, 1992, *available in* LEXIS, World Library, Mtlr File.

[84] Terry McDermott, *Turnover and Absenteeism Rates Remain Obstacles to TQM in Maquiladora*, BUS. MEX., Nov. 1994, at 42. According to a survey from the American Chamber of Commerce of Mexico, nearly 90 percent of all respondents claim that turnover is the main obstacle to effectively implementing innovative management strategies in Mexico. *Id.* For example, total quality management (TQM) has become a

population, low skills of operators, and poor urban facilities, transportation, housing and services."[85] Particularly, a lack of "concentration on the work discipline, commitment and responsibility" in the Mexican educational system are the main reasons for high turnover and absenteeism in Mexico.[86]

To counter absenteeism, some investors have provided free meals, athletic activities, bus transport, or some extra bonuses, such as $5 a week for perfect attendance and timeliness.[87] These incentives have had some positive influence in reducing absenteeism,[88] but they also represent the hidden costs behind the low wage rate of the Mexican workers. In addition, the high turnover obliges the investors to continuously recruit and retrain new workers, and thus, inevitably increases the management's difficulty and costs.[89]

Third, cultural differences and language barriers are also challenges for investors in their Mexican operations. These challenges are particularly difficult for those enterprises from Asia.[90] Many investors try hard, but unintentional failure to work within, or be aware of, Mexican culture often leads to poor performance in their Mexican operations.[91] For instance, Mexican men tend to have a strong sense of "machismo," which manifests itself in certain behaviors, such as reluctance to admit mistakes or

part of competitive strategies in many industries. *Id.* However, many foreign companies find high turnover and absenteeism are major obstacles for them to implement TQM effectively. *Id.* According to a report from the American Chamber of Commerce of Mexico, high turnover and absenteeism may also be attributed to cultural needs that are not addressed by foreign managers. *Id.*

85 *Id.*

86 *Id.*

87 Mariah E. deForest, *When in Mexico....; Cultural Awareness Is Key to Productivity in Maquiladora Plants*, BUS. MEX., July 1991, *available in* LEXIS, World library, Busmex File.

88 McDermott, *supra* note 84, at 44.

89 Martha H. Peak, *Maquiladoras: Where Quality Is a Way of Life*, MGMT. REV., Mar. 1993, at 19,22. *See also* deForest, *supra* note 87.

90 For instance, the lack of diplomatic relation between Taiwan and Mexico has seriously hampered bilateral interactions for nearly two decades. *PM Lien Opens New Page in Taiwan-Mexico Ties*, CENT. NEWS AGENCY, June 7, 1994, *available in* LEXIS, News Library, Wires File.

91 deForest, *supra* note 87. For instance, another hindrance to U.S. implementation of TQM in their maquiladora operations in Mexico is the cultural differences between U.S. Japan, and Mexico. *See generally* McDermott, *supra* note 84, at 42.

ignorance, and unwillingness to do what they consider women's work.[92] This machismo attitude of male Mexican workers sometimes not only affects the production output, but it also increases the difficulty of labor management.[93]

Fourth, the Mexican legal framework has a strong influence on investors' human resource practices in Mexico. Due to the historical importance of worker organizations in Mexican politics, the Mexican legal structure has a pro-labor tendency represented in detailed constitutional and statutory framework.[94] Article 123 of the Mexican Constitution[95] in conjunction with the Federal Labor Law (FLL) regulates all Mexican labor practices. This legal structure gives legal protections and benefits strongly favorable to the Mexican workers, and even goes beyond what investors can expect. Hence, despite the attractive minimum wage in Mexico, many fringe and labor-law benefits are required by the FLL for the Mexican workers, and thereby inevitably increase investors' operation costs.[96] For example, the FLL requires employers to pay 5 percent of payroll to the National Housing Fund to provide preferable financing terms for workers to purchase houses.[97] These

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92 Teagarden et al., *supra* note 72, at 39.

93 *Id.* at 42. A U.S. automotive parts company experienced high quality ratings in its Mexican operation. *Id.* However, the general manager of the company was confused by the low production efficiency and inexplicably high raw-material costs. *Id.* After secretly scrutinizing the Mexican production lines, the management found that "the Mexican supervisors were too proud to confess they did not know how to adjust the malfunctioning equipment. *Id.* Therefore, they chose to discard bad pieces. *Id.*

94 Ann M. Bartow, *The Rights of Worker in Mexico*, 11 COMP. LAB. L. 182 (1990). The reason why Mexico has a pro-labor tendency legal framework is because Mexican worker organizations played a significant role in the success of the Mexican revolution of 1910-17. *Id.* Therefore, when drafting a new Constitution in 1917, the authors incorporated extensive constitutional protections for laborers. *Id.* Even though the Mexican Constitution has experienced several amendments, further protections in worker rights have been added. *Id.*

95 Constitución Politica de los Estados Unidos Mexicanos, art. 123 [hereinafter MEXICAN CONSTITUTION] For an English translation of the Mexican Constitution see DOING BUSINESS IN MEXICO, Part 1, app. 2 (Andrea Bonime-Blanc & William E. Mooz, Jr. ed. 1995). Article 123 specifically delegates to the Mexican Legislature, the Congress of the Union, the power to enact the laws that apply to all Mexican workers, day laborers, domestic servants, and artisans, and to all labor contracts in a general way. *Id.*

96 *See infra* notes 97-99 and accompanying text.

97 The Mexican Federal Labor Law [hereinafter FLL], art. 136, 137. *See* 2 COMMERCIAL LAWS OF THE WORLD: MEXICO LABOR LAWS, 26 (1995) (English text of the Mexican Federal Labor Law).

fringe and labor-law benefits represent significant hidden costs behind the attractive low wage rate and commonly amount to 70 to 100 percent of the basic payroll.[98] In addition, the FLL also imposes comprehensive requirements in labor management practices of employers, such as recruitment, promotion, training and termination, thereby affecting investors' overall management strategies.[99] As a result, this pro-labor legal framework not only increases investors' operational costs but also significantly complicates worker-employer relations in Mexico.

Despite the labor practices that are a challenge to foreign operations in Mexico, Mexico still provides many favorable incentives for foreign investors to locate their operations in this country. Particularly, the peso crisis has cut dollar-term wages by 42 percent.[100] Furthermore, the lack of skilled personnel and high turnover problems have significantly improved in 1995. Because of the 1995 recession, many Mexican and foreign firms have laid off workforce or frozen hiring, thereby creating a pool of factory labor, skilled technicians, and even management executives.[101] To truly counter challenges in cross-cultural labor issues in Mexico, however, investors need to flexibly implement their international human resource management strategies such as localizing management to Mexicans, proper employee training, and productivity driven wage changes, and thus truly take advantage of the competitive low cost and abundant Mexican labor resources.

D. Bureaucratic Red Tape and Insufficient Infrastructure

Aside from the numerous challenges discussed above,

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98 Winsor, *supra* note 65, at 89, 91. In addition to the 5 percent of the National Housing Fund, there are many other fringe benefits required by the FLL, such as medical expenses, old age pensions, disability pensions, and worker compensation. *Id.* Also, the Mexican workers are entitled to receive a Christmas bonus, which normally accounts for at least fifteen days' of salary. *Id.*

99 For instance, article 159 of the FLL requires that promotion be based exclusively on seniority. See FLL, *supra* note 97, art. 159. If investors want to change their appraisal system toward a merit-based one, they need to enter into a complicated and time-consuming collective bargaining agreement. *Id.* In addition, investors are also responsible for all the training programs regarding the changes. *Id.*

100 ECONOMIST INTELLIGENCE UNIT, *Mexico, 10.00 Human Resource—10.01 Overview*, INVESTING LICENSING & TRADING, Sept. 1, 1995, *available in* LEXIS, World Library Inlitr File.

101 *Id.*

Mexico's bureaucratic red tape and insufficient infrastructure represent other obstacles for foreign investment entry into Mexico. First, red tape considerably undermined the shaping of a favorable investment in Mexico.[102] Many investors applaud "the macro level changes which have recently taken place in Mexico and the commitment to service investors shown by the Mexican federal government."[103] However, some investors have been frustrated by the lack of micro level changes and the local bureaucratic bottlenecks that still exist.[104]

In one respect, the bureaucratic problems encountered by investors are not that surprising in Mexico. Bureaucratic procedures exist everywhere in the world, and Mexico is no exception to this fact. While most foreign investors expect a certain amount of red tape in establishing new foreign companies in Mexico, many were astonished at the extent of costs -in both time and money- of the process.[105] It appears that the philosophical changes occurring at the federal level have yet to filter down to the state and local level, where much of the traditional bureaucratic inertia still exists.[106] To facilitate dealing with bureaucratic snags, investors need to spend more time investigating local regulations and working with local officials.

Second, insufficient infrastructure has also hampered direct foreign investment in Mexico such as poor transportation,[107] a poor

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[102] *Investors Comment on Mexico*, BUS. MEX., Jan.-Feb. 1992, *available in* LEXIS, World Library, Busmex File.

[103] *Id.*

[104] Gray Newman, *Laying Down the Law Enforcement Trends in Environmental Protection*, BUS. MEX., Jan.-Feb. 1993. Local bureaucracy is the most daunting obstacle to foreign investment in Mexico. *Id.* An experience from a foreign company located in the state of Queretaro may be the best example. *Id.* at 77. The company's plant had been approved by federal officials in its environmental requirements, but local authorities refused to allow it to operate. *Id.* Eventually, the company was able to bring the matter to the attention of federal authorities who overruled the local authorities, but that tactic could be more difficult if local agencies have primary authority in environmental matters. *Id.* In addition, many investors are surprised by Mexican bureaucracy in many other respects. deForest, *supra* note 87. For example, to obtain a post office box involves several months of negotiation with bureaucrats, and materials urgently needed for production sit on the other side of the border waiting for lost entry permits. *Id.*

[105] *Investors Comment on Mexico*, *supra* note 102.

[106] *Id.*

[107] Alejandro Castillo, *A Look at Mexico's Infrastructure, The Challenge to Deliver*,

communication system,[108] and inefficient electricity[109] and water supplies.[110] Quite often, foreign investors have been confronted with big operational problems due to the insufficient infrastructure.[111] In addition, the inadequate infrastructure also causes difficulties for investors to utilize Mexico's resources in their Mexican operations.[112] This problem is particularly significant in the maquiladora industry.[113] Due to the poor infrastructure, only 2 percent of materials come from Mexico because maquiladora investors find that it is easier and cheaper to truck or ship materials across the border than to transport goods inside Mexico.[114]

Although the Mexican government has made considerable efforts to remedy these obstacles, including privatization of transportation and telecommunication sectors,[115] it will take a long

BUS. MEX., July, 1993, *available in* LEXIS, World Library, Busmex File. Mexico has no navigable rivers, and thus, the highway and rail systems are the chief methods of transportation. *Id.* Currently, Mexico has only 243,000 kilometers of roadways, and nearly half of the roadways are unpaved dirt roads. *Id.* Even though the Mexican government has put 3078 kilometers of highway into service since 1988, maintenance of the highway network has been insufficient. *Id.* at 7. Some estimates have found that "60 percent of the highway network was in poor condition." *Id.* In addition, the railway system only has limited capacity and is underutilized. *Id.* Therefore, compared with its northern partners, transportation in Mexico is untimely, unsafe and costly. *Id.*

108 Martha H. Peak, *Mexican Miracle: How the U.S. Can Profit From NAFTA; North American Free Trade Agreement*, MGMT. REV., Mar. 1993, at 17. Telephone service is inadequate throughout the country. *Id.* Only four to five per 100 households have hard-wired telephones. *Id.* In addition, the failure rates of getting through phone calls are higher than 20 percent. *Id.*

109 *Id.* Electrical outages are frequent in Mexico, thus, investors find that their production lines are frequently disrupted by power surges and brown-outs. *Id.*

110 William A Reed, & Miguel Montero, *Will NAFTA-Mexico Be A Plus or Minus for You?* TEXTILE WORLD, Feb. 1993, at 35. Insufficient water supply also poses constraint for foreign operations in Mexico, particularly in the textile industry, which needs sufficient water for dyeing, printing, and finishing process. *Id.*

111 deForest, *supra* note 87. For instance, businessmen has complained about the poor infrastructure as well as inefficiency in Veracruz, a major port located on the Gulf of Mexico. Lawrence Kootnikoff, *Port Take-Over Good for Mexican Trade, Businessmen Say,* BC Cycle, June 1, 1991, *available in* LEXIS, World Library, Txtcsa File.

112 Martha H. Peak, *Maquiladoras: Where Quality Is A Way of Life*, MGMT. REV., Mar. 1993, at 20.

113 *Id.*

114 *Id.*

115 James Brooke, *Latin America's Privatization Path*, N.Y. TIMES, Nov. 12, 1994, at 38. Currently Mexico has 3,000 privatized toll roads. *Id.* In addition, the country intends to privatize its railroad systems and satellites sector for long distance

time to solve these kinds of fundamental problems. To confront the infrastructure problems, investors are advised to have self-defense devices, such as using cellular systems for better communication, and installing back-up generators for the frequent electrical outages. In addition, investors are advised to locate their operations near major cities or near the Mexican northern border, which can provide better infrastructure.

Gradual progress in reducing Mexico's bureaucratic red tape and improving insufficient infrastructure can be expected. A streamlining of the bureaucratic red tape has already occurred in the Mexican federal government suggesting that this could also be achieved in the state and local governments, with the proper commitment and a combined effort.[116] In addition, the Mexican government should more actively encourage foreign investors to participate in building infrastructure by providing special incentives.

Although there are investment difficulties in Mexico, investors thinking of participating in this surging economy are looking at a market of 86.6 million people.[117] In addition, Mexico, the thirteenth largest country in the world,[118] is a country with a great diversity of natural resources,[119] replete with young human resources.[120] Its strategic geographic location as a bridge between North and Latin America has placed Mexico at a strong

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telecommunication. Martin Langfield, *Mexico: Mexico Clear Way for Satellite Rail Privatization*, REUTERS, Jan. 30, 1995, *available in* LEXIS, World Library, Txtcsa File.

116 *Investors Comment on Mexico*, *supra* note 102.

117 ECONOMIST INTELLIGENCE UNIT, *supra* note 56, at 3.

118 *See* Winsor, *supra* note 65, at 3. Mexico covers 746,000 square smiles and is also the third largest country in Latin America after Brazil and Argentina.

119 Banco de Mexico, *supra* note 13, at 42. Mexico produces a great variety of crops and is rich in minerals. *Id.* Currently, Mexico is one of the ten largest producers of corn, coffee, soybeans, sorghum, beans, tomatoes and ranks tenth in the world in meat production. *Id.* In addition, Mexico is ranked the largest silver producer, sixth largest oil producer, and eighth in terms of proven natural gas and crude oil reserves in the world. *Id.*

120 *Country: Mexico.*, ABC-CLIO, Feb. 20, 1995, *available in* LEXIS, World Library, Profile File. Mexico currently has a work force of 28 million people and is the second youngest in the world. *Id.* Moreover, an additional 12 million workers will enter the force over the next ten years, since nearly 30% of the population is between the ages of 16 and 30. Winsor, *supra* note 65, at 88. Furthermore, Mexican workers are relatively well-educated and Mexico has the lowest illiteracy rate among the Latin American countries. Teagarden et al., *supra* note 72, at 41.

comparative advantage vis-à-vis other countries.[121] Moreover, the widespread economic, political, and regulatory reforms are likely to speed the pace of Mexico's economic recovery from the peso crisis. As these reforms come to fruition, Mexico has great potential for the same economic takeoff as experienced in Asian NICs. As a result, the international business community cannot afford to ignore this emerging country.

III. Legal Reforms in Mexican Foreign Investment Regime

Recent social, economic, and commercial developments in Mexico have caused changes to important Mexican laws that directly affect the participation of foreign parties in the Mexican economy. The enactment of the new Foreign Investment Law has significantly broadened investment opportunities in Mexico's economic activities, which were restricted under the old law.[122] In addition, the Mexican government has significantly strengthened the intellectual property protection regime through the enactment of the 1991 Law for the Promotion and Protection of Industrial Property,[123] and a companion amendment in Mexico's Copyright Law.[124] Moreover, Mexico's new maquiladora program also plays a significant role in attracting foreign investment.[125] All these legal reforms are intended to improve Mexico's foreign investment regime and attract foreign investors to participate in the Mexican economy. Therefore, an understanding of these laws can be very helpful to foreign investors who are making decisions about their investment projects.

A. Foreign Investment Law

In order to strengthen Mexico's competitive position in attracting foreign investment, Mexico recently enacted a new Foreign Investment Law, which came into effect on December 28,

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[121] Mexico's geographical location is south of North America. It shares a 3234 kilometer border with the United States to the north and borders Guatemala and Belize to its south. Mexico also possesses coastlines facing the Pacific Ocean in its West and Caribbean Basin and Mexico Bay in its west.

[122] *See infra* notes 126-64 and accompanying text.

[123] *See infra* notes 165-94 and accompanying text.

[124] *See infra* notes 195-213 and accompanying text.

[125] *See infra* notes 214-49 and accompanying text.

1993.[126] This FIL repealed the complex, inward looking, and defensive policies of its predecessor, the 1973 Foreign Investment Law,[127] and dramatically changed the regulatory framework of foreign investments in Mexico.[128]

1. Policy

The main purpose of the FIL is to define the rules applicable to foreign investment in Mexico and to ensure that foreign investment contributes to the economic development of Mexico.[129] However, an implicit objective of the new law is to provide legal certainty and clear rules for foreign investors.[130] Prior to the enactment of the FIL, foreign investments in Mexico were regulated by both the 1973 Foreign Investment Law and the 1989 Investment Regulation.[131] This two-track operation came about in 1989, when President Salinas used his prescriptive powers to promulgate the regulations that substantially liberalized and deregulated some provisions of the 1973 Law. However, under the Mexican legal system, the regulations could be easily and directly modified at any time, thus reducing the level of certainty in foreign investment.[132] In addition, the interaction of the 1973 Law and the 1989 Regulations also created a complicated legislative environment because the 1989 Regulation exceeded the scope of the 1973 law in many respects.[133] Therefore, the

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126 Ley de Inversión Extranjera, D.O., 27 Diciembre 1993 [Foreign Investment Law, December 27, 1993], [hereinafter FIL]. For English text of the Mexican Foreign Investment Law see DOING BUSINESS IN MEXICO, *supra* note 95, pt. IV, app. 2.

127 Ley para Promover la Inversion Mexicoana y Regular La Inversion Extranjera, D.O., Mar. 9, 1973 (repealed 1993) [hereinafter 1973 Law].

128 1 DOING BUSINESS IN MEXICO, Part VI, §1.02, at 1-4 (Andrea Bonime-Blanc & William E. Mooz, Jr. ed. 1996)

129 FIL, *supra* note 126, art. 1.

130 Agustin Berdja-Prieto, *Mexico Streamlines Foreign Investment Law*, INT'L FIN. L. REV., Feb. 1994; Raymond Bravo H., *Mexican Legal Framework Applicable to Operations Involving Financial Services*, 25 ST. MARY'S L.J. 1239, 1240-41 (1994).

131 Reglamento de la Ley para Promover la Inversión Mexicana y Regular Inversión Extranjera 1989. [Regulation of the Law to Promote Mexican Investment and to Regulate Foreign Investment 1989], [hereinafter 1989 Regulation]. For English text of 1989 Regulation see DOING BUSINESS IN MEXICO, *supra* note 95, at Part IV app.4.

132 Bravo H., *supra* note 130, at 1241.

133 J. Hayden Kepner, Jr., *Mexico's New Foreign Investment Regulations: A Legal Analysis*, 18 SYRACUSE J. INT'L L. & COM. 41, 58-59 (1992). For instance, the 1973

interaction between the 1973 Law and the 1989 Regulation raised a number of issues concerning the 1989 Regulation's constitutionality and legality.[134] In response, the FIL has removed these uncertainties and created a clearer legal framework for foreign investments.

2. Definition and Scope of Foreign Investment

The new Mexican Foreign Investment Law substantially broadens the definition of foreign investors and provides a greater scope for foreign participation in its key economic sectors, as compared to the 1973 Law. Almost all kinds of foreign investors are permitted to invest in Mexico, including any "non-Mexican individual, corporation, partnership, and any non-incorporated foreign entities."[135] In addition, foreign investment is defined as (i) the participation of foreign investors in any portion in the corporate capital of Mexican companies, (ii) investment carried out by Mexican companies in which foreign investors have a majority equity participation, and (iii) the participation of foreign investors in activities and acts contemplated by the FIL.[136]

As a general rule, foreign investors have no restrictions preventing (i) participation in any proportion in the corporate capital of Mexican companies, (ii) the purchase of fixed assets, (iii) joining new economic activities or producing new products, or to (iv) opening, operating, expanding, and relocating existing establishments.[137] Generally, this new regulatory framework improves the restrictive 1973 law's strict limitation of foreign investments in Mexican companies to 49 percent or less.

However, the FIL specifies four categories of activities in which foreign investors are prohibited from participating. The first category includes the activities exclusively reserved for the

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Law requires prior approval for any foreigners having more than 49 percent ownership of Mexican companies but the 1989 Regulation allows 100 percent foreign ownership in most industries without requiring prior approvals. *Id.*

134 The 1989 Regulation seems to be unconstitutional because it is not consistent with the 1973 Law. *Id.* at 72, 73. Thus, foreign investors could be vulnerable in Mexico, if the 1989 Regulation were declared unconstitutional by the Supreme Court of the Mexico. *Id.* at 73.

135 FIL, *supra* note 126, art. 2, sec. III.

136 *Id.* sec. II.

137 *Id.* art. 4.

Mexican state.[138] The FIL exclusively reserves for the Mexican state certain strategic industries, such as oil and basic petrochemicals, to comply with the Mexican constitutional requirement.[139] Neither Mexican nor foreign investors may engage in these restricted areas of economic activity.[140] The second category includes activities such as radio broadcasting and land transportation, which are reserved exclusively for Mexican individuals and Mexican companies without foreign equity participation.[141] Foreign investors may not use any direct or indirect mechanisms to engage in and obtain control of these activities.[142] The third category includes activities in which foreign investment may participate only in a minority position. For those specified sectors, the FIL limits direct foreign ownership or participation to either 10, 25, 30, or 49 percent.[143] The fourth category includes activities where foreign investors are required to obtain prior approval from the Foreign Investment Commission in order to own more than 40 percent.[144]

Although the economic sectors mentioned above have not been expressly opened to foreign investment, the FIL does provide other alternatives for foreign participation in these restricted activities. For example, subject to a screening procedure, foreign investors may participate in activities reserved for the Mexican people through neutral investment with limited or non-voting rights.[145] In addition, with prior approval of the Foreign Investment Commission, foreign investors may acquire existing

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138 *Id.* art. 5.

139 *Id.*

140 *Id.* art. 5.

141 FIL, *supra* note 126, art. 6.

142 *Id.* art. 7.

143 *Id.* These limitations are as follows: (i) up to 10 percent in production cooperatives, (ii) up to 25 percent in domestic and specialized air transportation service, (iii) up to 30 percent in financial holding companies, commercial banks, securities firms and specialists, and (iv) up to 49 percent in other service industries, such as insurance, financial, leasing, newspaper, publication, and telephone service. *Id.*

144 FIL, *supra* note 126, art. 8. This category includes activities, such as maritime transport and certain port services. *Id.*

145 *Id.* art. 19. Neutral investment means investment in a Mexican corporation or partnership through authorized special trusts. *Id.* art 18. Such investment will not be computed to determine the percentage of foreign investment in the capital of Mexican company. *Id.*

Mexican-owned companies regardless of the activities in which these companies are engaged.[146]

3. *Registration and Approval Procedures*

The procedures of registration for foreign investments regulated under the FIL have been simplified. As a general requirement, all foreign investors are required to obtain a prior permit from the Ministry of Foreign Relations when establishing a corporation or partnership in Mexico.[147] The foreign investors have to obtain prior approval from the Ministry of Commerce and Industrial Development (SECOFI) to register in the Public Commerce Registry in order to engage in economic activities in Mexico.[148] The FIL also requires SECOFI, within 15 business days, to grant such applications which comply with corresponding legal requirements.[149] Furthermore, all foreign investments, whether subject to prior approval or not, have to be registered with the National Registry of Foreign Investment.[150]

For certain activities which are subject to the screening procedures of the Foreign Investment Commission, foreign investors need to file an application to obtain approval.[151] Article 29 of the FIL sets four criteria which the Foreign Investment Commission must observe upon evaluating applications for investment.[152] These criteria are: the impact on employment and workers' training, technological contribution, environmental concerns, and the contribution to competitiveness of Mexico's manufacturing sector.[153] In addition, the Commission must have a formal response to the application within 45 working days from its presentation; otherwise, the application shall be deemed approved.[154] Obviously, the "deemed approval" concept is very

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146 *Id.* art. 9.

147 *Id.* art. 15.

148 FIL, *supra* note 126, art. 17.

149 *Id.*

150 *Id.* art. 32.

151 *Id.* art. 9.

152 *Id.* art. 29.

153 *Id.*

154 *Id.* art. 28.

helpful in reducing bureaucratic impediments and in improving the efficiency of foreign investment application procedures..

4. *Capital Repatriation and Profit Remittance*

The FIL Law does not impose any general restrictions or limitations on the remittance of profits or repatriation of capital to foreign countries, which is consistent with the Mexican government's abolition of its foreign exchange control.[155] Therefore, there are no restrictions on the remittance of initial or subsequent investments, when general legal requirements, such as paying taxes, are met.

5. *Acquisition of Real Estate Property*

The FIL has greatly facilitated foreign access to Mexican real estate by diminishing and removing the legal and bureaucratic obstacles. In general, foreigners may hold legal and beneficial titles of real property outside the restricted zone in Mexico.[156] Within the restricted zone, the Mexican Constitution excludes foreign access.[157] The FIL, however, narrowly interprets the Mexican Constitution to soften the constitutional limitation in the restricted zone and allows Mexican companies with foreign equity to directly acquire real property for industrial or commercial use in the restricted zone.[158] The only requirement is to register with the Ministry of Foreign Relation.[159] The FIL also allows foreign access indirectly to the restricted zone for residential use. Foreigners may obtain a permit from the Ministry of Foreign Relation and hold real estate for residential use through a Mexican

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155 Jonathan E. Heath, *Economic Perspectives for 1992*, BUS. MEX., Dec. 1991, *available in* LEXIS, World Lib., Txtcsa File. Since 1982, foreign exchange has been subjected to restrictive government control and has been intended to curb capital flight. *Id.* However, the Salinas administration abolished the foreign exchange controls in November 1991 to be consistent with its free market oriented reforms. *Id.*

156 FIL, *supra* note 126, art. 10.

157 Under article 27, section 1 of the Mexican Constitution, foreign individuals and entities may not hold legal titles to real estate in Mexico located within 100 kilometer from the border or 50 kilometers from the coastline. MEXICAN CONSTITUTION, *supra* note 95, art. 27, § 1.

158 FIL, *supra* note 126, art. 10.

159 *Id.*

trust.[160] Additionally, the FIL prolongs such trusts to a term of 50 years, as opposed to 30 years under 1973 law.[161] In addition, the "deemed approval" concept is also subject to a screening procedure if the Ministry of Foreign Relations does not respond to the application within 30 business days.[162]

In general, the FIL has removed constitutional uncertainty and enhanced legality in the foreign investment domain and thereby created a more straightforward legal framework for foreign investment. It has broadened and deregulated the foreign investment scope and application procedures. As a result, the new law creates a more transparent and investor-friendly set of rules and procedures for foreign investors in Mexico. However, the FIL does not fully liberalize the scope of foreign investment, and still imposes some restrictions in its foreign investment scope.[163] These restrictions unavoidably limit foreign investors' participation in Mexico's economic activities. Further, Mexico's peso crisis has strongly shaken investors' confidence in Mexico and thereby has influenced foreign investment inflow.[164] Therefore, the Mexican government needs to first restore foreign investors' confidence. In addition, the Mexican government has to further liberalize the scope of foreign investment and ease the restrictions for foreign participation in order to encourage more foreign investors to participate Mexico's economy.

B. Law on the Promotion and Protection of Industrial Property

On June 27, 1991, Mexico enacted the Law on the Promotion and Protection of Industrial Property[165] and repealed the 1982

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[160] *Id.* art. 11.

[161] *Id.* art. 13.

[162] *Id.* art. 14.

[163] *See supra* notes 138-44 and accompanying text.

[164] Elisabeth Malkin, *It's Better in La Provincia*, BUS. WK., Nov. 13, 1995, at 118. Due to the peso crisis, the inflow of direct foreign investment has significantly decreased to less than half of 1994's $8 billion. *Id.*

[165] Ley de Fomento y Protecion de la Propiedad Industrial [Law on the Promotion and Protection of Industrial Property], was enacted on June 27, 1991, and most redcently amended in August 2, 1994, [hereinafter The Industrial Property Law]. For English text of The Industrial Property Law see DOING BUSINESS IN MEXICO, *supra* note 95, at Part III, app. 2.

Transfer of Technology Law and the Transfer of Technology Regulations of 1990.[166] The Industrial Property Law completely rebuilds the Mexican industrial property regime by integrating new intellectual properties and by extending its term of protection.[167] This law also indicates Mexico's great efforts in moving toward a global economy framework.

1. Policy

The Industrial Property Law expresses as its objective the protection of industrial property rights, such as patents and trademarks, through increased regulation, enforcement, and penalties.[168] The law is also designed to help Mexican businesses produce new technologies as part of Mexico's efforts at modernization[169] and to leave behind the economic debacle of the 1980s. Moreover, an unstated policy of enacting the Industrial Property Law is to strengthen Mexico's attractiveness to foreign investors.[170] The law signals to potential foreign investors that the technology they bring with them to Mexico will be protected under a regulatory system similar to that of industrialized nations.[171] As a result, Mexico has dramatically eliminated another barrier to foreign investment and has fostered a good business climate to attract foreign investments and advanced technology.

2. Scope and Term

The Industrial Property Law significantly broadens protection for the following categories of goods:

a. Patents, Utility Models, and Industrial Designs

The Industrial Property law specifically broadens its patentable scope to chemicals, pharmaceuticals, biotechnology products,

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166 DOING BUSINESS IN MEXICO, *supra* note 95, pt. IV, § 1.01, at 1-2.

167 *See infra* notes 174-76 and accompanying text.

168 *See infra* notes 187-94 and accompanying text.

169 The Industrial Property Law, *supra* note 165, art. 2.

170 Jorge Arciniega and Nancy Ramirez, *Mexico's New Industrial Property Law—New Protection for Foreign Investors*, 1 MEX. TRADE & L. REP. No. 1, Oct. 1, 1991, *available in* LEXIS, World Library, Mtlr File.

171 *Id.*

alloys and agrochemical products.[172] The term of a patent is 20 years from the date of filing the application.[173] The Industrial Property Law also introduces utility models as a new form of protection and gives a non-renewable 10 years of protection.[174] The idea is to encourage industrial innovation among small companies and individuals because they normally have limited research and development resources which are instrumental in producing patentable innovations.[175] Since most Mexican companies are small and medium-size entrepreneurialships, the protection of utility models is particularly suitable for local Mexican companies. The protection of utility models also represents an incentive for investment by NICs, such as Taiwan, which have industrial structures similar to those of Mexico.[176] The Industrial Property Law also allows protection for industrial designs that may take the form of either drawings or models for a nonrenewable 15 years.[177]

b. Commercial Designations

The Industrial Property Law allows collective marks, which are issued by industry associations to designate the products or services of their respective members, to be registered for protection in Mexico.[178] In addition, trademarks, service marks, trade names, and commercial slogans may also be registered for renewable terms of 10 years from the date of filing the application.[179]

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172 *See* The Industrial Property Law, *supra* note 165, art. 16.

173 *Id.* art. 23. The original patentable term in Transfer Technology Law is 14 years. *See* DOING BUSINESS, *supra* note 95, at pt. IV, § 2.02, at 2-6.

174 The Industrial Property Law, *supra* note 165, art. 28, 29.

175 John B. McKnight & Carlos Muggenburg R.V., *Mexico's New Intellectual Property Regime: Improvements in the Protection of Industrial Property, Copy, License, and Franchise Rights in Mexico*, 27 INT'L LAW. 27,33 (1993).

176 Philip Liu, *Taiwan: Government Steps Up Help for Small and Medium Enterprises*, BUS. TAIWAN, Sept. 19, 1994, *available in* LEXIS, World Library Txtfe File. 96.5 percent of the companies in Taiwan are small and medium-size companies. *Id.*

177 The Industrial Property Law, *supra* note 165, art. 36.

178 *Id.* art. 96.

179 *Id.* arts. 95, 103, 110.

c. Industrial or Trade Secrets

The Industrial Property Law also recognizes the need to protect industrial secrets. An industrial secret is information which gives a party a competitive or economic advantage against third parties, or is the subject of adequate methods or practices to ensure its confidential nature and restricted access.[180] The extension of protection to industrial secrets shows Mexico's effort to attract foreign investors who have nonpatentable know-how which can contribute to Mexico's competitiveness and economic advantage. However, the protection of industrial secrets is still controversial. Since a secret is confidential to the parties, it should not be subject to disclosure in order to obtain the government's authorization or registration.[181] In addition, the subjective nature of the statutory elements constituting industrial secrets are difficult to prove.[182] The current absence of injunctive relief for unauthorized disclosure or use of secrets also raises serious doubts about its effectiveness in industrial secret protection under the Industrial Property Law.[183] Therefore, the protection of industrial secrets seems meaningless to investors.

3. License and Transfer of Technology Procedures

The Industrial Property Law tries to reduce the technology transfer barriers to a minimum. It eliminated SECOFI's screening procedure of the terms of the parties' license and transfer agreement which was imposed by the 1982 Transfer of Technology Law.[184] It only requires registration of patents and trademark licensing and transfers with the SECOFI to effectively protect the transfers or licensing against improper use by third

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180 *Id.* art. 82.

181 Mcknight & Muggenburg R.V., *supra* note 175, at 34.

182 *Id.*

183 *Intellectual Property Enforcement Issues to Play Major Role in NAFTA*, 8 Int'l Trade Rep. (BNA), No. 42, at 1553 (Oct. 23, 1991). Historically, the Mexican judicial system has not recognized pretrial remedies. *Id.* Mexico's enforcement "depends on a mixture of civil, administrative, and criminal procedures," and thus injunctive relief is not a part of the Mexican legal system, as it is in the U.S., where interlocutory injunctions play a prime role. *Id.*

184 Arciniega & Ramirez , *supra* note 170.

parties.[185] In addition, requirement for registration of a licensing or transfer has also been improved. The Industrial Property Law only denies registration of a licensing or transfer when such a trademark is not effectively registered in Mexico.[186] Therefore, the improved licensing and transfer procedures under the Industrial Property Law is likely to facilitate the flow of foreign technology into Mexico.

4. Protection and Enforcement

Because of the infamous reputation of piracy in Mexico, the Industrial Property Law specifically provides for a three-tier protection for a legal holder of industrial property.[187] First, it provides several administrative measures, such as on-site inspection of locations where goods violating the industrial property law are suspected to exist.[188] Secondly, it incriminates the misappropriator and unauthorized user, if the purpose of the use is for the attainment of economic benefit.[189] Finally, the industrial property holder may also bring civil action for his damages against the infringer.[190] In most cases, civil actions are brought contemporaneously with the initiation of administrative or criminal proceedings in order to reduce the litigation period.[191] Nevertheless, due to the slowness of the Mexican judiciary system and its offering of considerably smaller compensation than developed countries, the incentive for pursuing civil damages for an infringement may not be significant to the holders of industrial property rights in Mexico.[192] Therefore, the underlying concern among foreign investors is whether the enforcement measures provided by the Industrial Property Law will be effectively implemented.[193] Effective implementation of enforcement

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[185] The Industrial Property Law, *supra* note 165, arts. 62, 63, 136, 143.

[186] *Id.*

[187] *See infra* notes 188-90 and accompanying text.

[188] The Industrial Property Law, *supra* note 165, art. 211.

[189] *Id.* art. 223.

[190] *Id.* art. 226.

[191] *See Intellectual Property Enforcement Issues to Play a Major Role in NAFTA*, *supra* note 183.

[192] *Id.*

[193] McKnight, & Muggenburg R.V., *supra* note 175, at 47.

measures will determine whether foreign investors' claims will be handled quickly by the relevant tribunal as well as whether sufficient money will be allocated to fund the government agencies carrying out the protection devices.[194] The Mexican government's success in attracting foreign investment and technology depends on these enforcement issues. Thus, to efficiently and effectively encourage the technology transfers, the Mexican government still needs to put great effort into convincing the foreign investors that their technologies will truly be protected in Mexico.

C. Copyright Law Reforms

On July 17, 1991, in a companion piece of legislation to the Industrial Property Law, the Mexican Congress enacted the decree "Reform and Add Various Provisions to the Federal Law of Authors' Rights" (the Decree) to amend its Copyright Law.[195] The fundamental policy of the copyright law amendment is to conform to the standards set by the Universal Copyright Convention[196] and the Berne Convention for the Protection of Literacy and Artistic Works.[197] Since Mexico has membership in both conventions, the Decree has assured foreigners that they will have protection for their copyright works in Mexico.[198]

The Decree makes various reforms to the Mexican Copyright Law to improve copyright protection. The most important of these reforms is to extend the protection of the Mexican Copyright Law to computer software, as well as to other areas of intellectual

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194 *Id.*

195 *Mexico's Copyright Law Revised*, 1 MEX. TRADE & L. REP. No. 3, Dec. 1, 1991, *available in* LEXIS, World Library, Mtlr File.

196 Universal Copyright Convention, Sept. 6, 1952, 6 U.S.T. 2732, 216 U.N.T.S. 132, *revised in* Universal Copyright Convention, July 24, 1971, 25 U.S.T. 1341, 943 U.N.T.S. 178.

197 Berne Convention for Protection of Literacy and Artistic Works, Paris Revision, done on July 24, 1971, *reprinted in* M. NIMMER & D. NIMMER, 4 THE LAW OF COPYRIGHT, app. 27 (1987). For an overview of interaction between Berne and the U.C.C., see Ralph Oman, *The United States and the Berne Union: An Extended Courtship*, 3 J. L. & TECH 71, 75 (1988).

198 M. Sean McMillen et al., *Mexico's Intellectual Property Law*, 15 LOY. L.A. INT'L & COMP. L.J. 975, 978 (1993).

property.[199] Thus far, the Mexican government has denied granting patents for computer software,[200] leaving the Decree to provide the only effective mechanism for protecting computer software in Mexico. The Decree specifically amends article 7 of the Mexican Copyright Law to extend its protection for computer software programs and audiovisual works. Therefore, protection against unauthorized infringement, such as copying and distributing, formerly applied to books and musical compositions is now also applicable to software programs. In addition, the length of copyright protection has been increased from 30 to 50 years.[201]

However, the copyright works registration is not mandatory in Mexico.[202] But a software owner is still entitled to identify itself as the sole legitimate source of the software and to take action against any unauthorized reproductions in Mexico, even if a software program is not registered with the Copyright Bureau.[203] However, registering in the Copyright Bureau is generally recommended in order to effectively support the position that the work qualifies for copyright protection.[204] To encourage software owners to register in the Copyright Bureau, the Decree also enhances confidentiality regarding copyright registration of their programs.[205] Accessing the files of software registrations can only be done through the consent of the Copyright Bureau or a judicial order.[206] Moreover, to discourage piracy, the decree also increased the criminal and civil penalties against infringers.[207]

In general, the copyright law reforms are intended to foster a favorable business climate to attract foreign investment, particularly in the computer industry. However, whether the reformed copyright law meets the expectations of foreign investors

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199 *See Mexico's Copyright Law Revised, supra* note 195.

200 *Mexico Lures High-Tech Exports by Reform of Investment, Intellectual Property Laws*, 10 Int'l Trade Rep. (BNA), No. 37, at 1583, 1584 (Sept. 22, 1993).

201 *See id.* at 1583-84.

202 McKnight, & Muggenburg R.V, *supra* note 175, at 38.

203 *Id.*

204 *Id.* at n.58.

205 Mexico's Copyright Law Revised, *supra* note 195.

206 *Id.*

207 *Id.*

will depend upon the extent the new laws are enforced.[208] The Mexican government vows to put its teeth into the new laws, and foreign investors have praised the Mexican federal attorney general's office for its actions on copyright infringement.[209] Nevertheless, the Mexican court system represents another barrier to the protection of foreign investors' copyrights. The U.S. firms Microsoft and Autodesk brought the first legal actions for copyright infringement under the reformed law.[210] In their civil actions, they experienced highly unreliable court action due to inefficiency and corruption, which permeate the court system.[211] Without a reliable court system in Mexico, foreign investors will doubt whether their legitimate rights can be truly protected in Mexico. Therefore, the Mexican government must also accelerate its pace on reconstructing its judicial system in order to effectively protect and assure foreign copyright holders. As it now stands, most copyright owners first pursue criminal action contemporaneously with civil action against infringers to effectively stop the infringement and reduce the lengthy court litigation process.[212] Then, the copyright owners usually reach settlements out of court with the infringers and receive some reimbursement.[213]

D. The Maquiladora Program

Mexico's maquiladora program is a highly significant force for Mexico in promoting foreign capital inflow, employment and industrialization. This program was originated in 1965 as part of the Mexico Border Industrialization Program.[214] The maquiladora program allows foreign manufacturers to temporarily import duty

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[208] *Id.*

[209] ECONOMIST INTELLIGENCE UNIT, *4.2 Protection of Intellectual Property*, INVESTING, LICENSING & TRADING CONDITIONS ABROAD: MEXICO, Sept. 1995, at 21, 23.

[210] *Id.*

[211] *See id.*

[212] *Id.*

[213] *Id.*

[214] Joshua Cohen, *A Case Study of Internationalization, the Rise of the Maquiladora*, BUS. MEX., Jan.-Feb. 1994, at 52, 53. In 1964, the U.S. repealed its Bracero Program, which allowed Mexican workers to enter the U.S. and work for seasonal farms. *See id.* Fearing high unemployment, Mexico established a maquiladora program as part of implementing its Border Industrialization Program. *Id.* at 52.

free intermediate materials which are used to assemble a product in Mexico, and subsequently export the product to the country of origin of the intermediate materials.[215] In the early 1980's, a devaluation of the peso led to a sharp decline in Mexican wages in relation to the dollar and boosted the growth of the maquiladora industry.[216] Therefore, by integrating low cost and profound human resources with special customs treatment, the maquiladora program has become an effective mechanism for Mexico in attracting foreign investment.[217]

In the past decade, the maquiladora industry has blossomed and contributed to Mexico's economy. Since the conception of the maquiladora, several presidential decrees have modified regulation of the maquiladora industry in response to changes in Mexico's economy. On December 23, 1993, Mexico published the Decree for the Development and Operation of the In-Bond Assembly (Maquiladora) Industry and effected the decree on January 1, 1994.[218] The fundamental object of the new Maquiladora Decree is to provide an expedited and decentralized mechanism to facilitate the operations of maquiladora corporations.[219] In addition, the 1994 decree has softened its mandatory export requirement as a response to the passage of NAFTA.[220]

1. Registration and Approval Procedures

The procedures of registration for maquiladora operation have been simplified under the Maquiladora Decree. As a general requirement, a foreign investor needs to have a corporate presence in Mexico to obtain the approval of a maquiladora operation.[221] In addition to the standard requirements associated with forming any

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215 *See Mexico's Maquiladora Industry*, *supra* note 83.

216 *Economic Comparisons*, *supra* note 18.

217 Daniel B. Wood, *An Economic Give and Take With Tijuana*, CHRISTIAN SCI. MONITOR, Aug. 12, 1996, *available in* LEXIS, World Library, Allwld File.

218 Foreign Tax Law Association, Inc., TAX L. WORLD: MEX. BOOK III 85 (1996) (setting forth the English Translation of the Mexican Maquiladora Decree). The Decree for the Development and Operation of the In-Bond Assembly (Maquiladora) Industry, effective Jan.1, 1994, will hereinafter be referred to as the "1994 Maquiladora Decree".

219 *Id.* (setting forth Article 1 of the 1994 Maquiladora Decree).

220 *See* DOING BUSINESS IN MEXICO, *supra* note 128, pt. VI, § 6.01, at 6-3.

221 DOING BUSINESS IN MEXICO, *supra* note 128, pt. VI, § 6.01, at 6-4.

company in Mexico, investors must apply to obtain a permit from SECOFI for their maquiladora operations.[222] A device, called the "Single Outlet," has been installed to facilitate the registration procedure. The outlet will carry out all the approval procedures, such as registrations in the National Commission of Foreign Investment and Federal Taxpayers Registry of the Ministry of Finance and Public Credit, through a single format.[223] Four criteria need to be met in order to obtain SECOFI's approval. The maquiladora company must: 1) generate employment, 2) contribute foreign currency, 3) foster the integration and competitiveness of the Mexican industry, and 4) facilitate technology transfers.[224] Once the maquiladora registration is approved, SECOFI will assign a maquiladora registry number to the qualified maquiladora applicant.[225] This number must be used in all governmental matters.

In order to reduce bureaucratic impediments and facilitate the operation of the newly established maquiladora companies, the Maquiladora Decree also requires the SECOFI to notify the Ministry of Finance and Public Credit about the terms of the approval within three business days from the date of approval.[226] Then the new maquiladora corporation can proceed with the temporary importation treatment for its production.

2. Temporary Importation

As mentioned above, the distinctive characteristic of the maquiladora company is its capability for temporary, duty-free importation. The Maquiladora Decree allows qualified maquiladora companies to temporarily import raw materials, equipment, machinery, and in general, anything needed to implement its activities and achieve its production goals, without

[222] Foreign Tax Law Association, Inc., *supra* note 218, at 85-86 (setting forth Articles 3 and 5 of the 1994 Maquiladora Decree). The permit also contains general information and approved terms of the maquiladora companies such as the manufacturing process and necessary equipment and raw materials to be temporarily imported. *Id.*

[223] *Id.* (setting forth Article 3 of the 1994 Maquiladora Decree).

[224] *Id.* at 85 (setting forth Article 2 of the 1994 Maquiladora Decree).

[225] *Id.* at. 86 (setting forth Article 7 of the 1994 Maquiladora Decree).

[226] *See id.* (setting forth Article 9 of the 1994 Maquiladora Decree).

paying any applicable customs duties.[227]

To guarantee that the imported items will be timely re-exported, the Mexican Customs Department requires a maquiladora company to post a surety bond.[228] The Mexican Customs Department will call upon the surety bond if the bonding maquiladora company cannot present evidence that the goods have been re-exported as required.[229]

3. *Domestic Maquiladora Sales*

Prior to NAFTA, maquiladoras could, under certain conditions, sell their products to the Mexican market for up to 50 percent of their total export sales during the preceding 12 months.[230] In response to the passage of NAFTA, however, the Maquiladora Decree has softened the mandatory export requirement somewhat. Beginning in 1994, a maquiladora was allowed to sell 55 percent of the total value of its annual exports for the previous year to the Mexican domestic market.[231] The quantity limitation will also be gradually eliminated because the decree will annually increase the quantity by 5 percent in addition to the 55 percent until the year of 2000.[232] In 2001, maquiladoras will then be able to sell their goods domestically without quantitative limitation.[233] In addition, the Maquiladora Decree requires the maquiladora companies to report the domestic sales to SECOFI.[234] Furthermore, all the products of maquiladora companies for domestic sale must maintain the same quality standard as those products for export and the companies must pay

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227 *See id.* (setting forth Article 10 of the 1994 Maquiladora Decree).

228 Rodolfo Villalobos & Bruce B. Barshop, *Social Infrastructure Needs of the Maquiladora Industry: A Proposal for United States Corporate Contributions*, 22 ST. MARY'S L.J. 701, 705 (1991).

229 Cheryl D. Hein & Neal R. Van Zante, *Maquiladoras: Should U.S. Companies Run for the Border?* CPA J., Oct. 1991, at 14, 16. This requirement also explains why maquiladoras are often called "in-bond assembly plants." *See* Villabos & Barshop, *supra* note 228.

230 1989 Mexican Maquiladora Decree, art. 20.

231 *See* Foreign Tax Law Association, Inc., *supra* note 218, at 88 (setting forth Article 19 of the 1994 Maquiladora Decree).

232 *Id.*

233 *Id.*

234 *Id.* at 89 (setting forth Article 20 of the 1994 Maquiladora Decree).

the general import tax.[235]

The expansion of maquiladora domestic sales also serves another purpose for the Mexican government. Since most maquiladoras are concentrated along the United States-Mexico border, the Mexican government has tried hard to encourage the maquiladoras to move into the interior of Mexico and to stimulate the economies in those regions.[236] Therefore, the liberalization of maquiladora domestic sales will likely accelerate the interior movement of maquiladoras.

4. *Future Development of Maquiladoras*

Before the establishment of NAFTA, special U.S. tariff concessions served as a competitive advantage to maquiladoras for those investors aiming at exporting to the U.S. market.[237] The maquiladora production has enjoyed favorable tariff treatment provided by the U.S. government through the Generalized System of Preferences (GSP) program and the Harmonized Tariff Schedule (HTS) production-sharing tariff provisions.[238] Under the HTS provisions 9802.00.60 and 9802.00.80, U.S. Customs provides benefits for maquiladora products which contain U.S.-made components destined for the United States.[239] Only value added portions produced in Mexico are liable for tariffs or duties.[240] The taxable value added portion is equal to the material, labor, and overhead costs incurred in Mexico.[241]

However, NAFTA changes the role of the maquiladoras. Eventually maquiladoras in their strictest definition will disappear

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235 *Id.* (setting forth Article 23.0 of the 1994 Maquiladora Decree).

236 David G. Waller, *Win/Win Maquiladoras*, TRANSP. & DISTRIBUTION, Feb. 1992, at 38, 40.

237 *See infra* notes 239-241 and accompanying text.

238 Elsie L. Echeverri-Carrol, *Maquiladoras: An Industry in Transition*, TEX. BUS. REV. June 1993.

239 *See Mexico's Maquiladora Industry*, *supra* note 83.

240 Under provision 9802.00.80, products assembled in foreign countries such as Mexico from component parts from the United States, are subject to duties only on the value-added portion. *Mexico's Maquiladora Industry*, *supra* note 83. Harmonize Tariff Schedule (HTS) 9802.00.60 provides duty-free tariff treatment for certain metal products from the United States which are processed in a foreign country and returned to the United States for further processing. *Id.*

241 *See* Hein & Van Zante, *supra* note 229, at 14.

due to tariff elimination by NAFTA. As was the case under the U.S.-Canada Free Trade Agreement,[242] the use of the production-sharing tariff provisions will likely diminish because the maquiladoras can trade goods duty-free, providing that their products comply with rules of origin under NAFTA.[243] Nevertheless, the tariff phase out period will be gradual because the full duty elimination for certain items scheduled will be as late as January 1, 2001.[244] During the period of tariff elimination, the maquiladoras can continue to benefit from production-sharing tariff provisions to export their products to the United States. Consequently, the maquiladora program will retain tariff advantages for foreign investors for a number of years.

Although its temporary importation mechanism will be gradually eliminated by NAFTA, the maquiladora industry is expected to grow prosperously, at least in the near future. This expectation is based on the ground that the maquiladora industry will benefit from NAFTA-related trade diversion to North American sourcing.[245] The recent performance of maquiladora operations can support such an expectation. In September, 1995, the maquiladora industry enjoyed a 28.3 percent real increase in its value added production over September, 1994 levels.[246] In addition, the recent sharp devaluation of the Mexican peso is likely to boost the growth of the maquiladora industry because the Mexican labor wage has also significantly plunged in terms of its dollar base.[247] Moreover, in order to strengthen their

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[242] Canada-U.S. Free Trade Agreement, Dec. 22-23, 1987 & Jan.. 2, 1988, Can.-U.S., *reprinted in* 27 I.L.M. 281, 293-402 (1988).

[243] *See NAFTA Will Greatly Improve Access to Mexican Market for Maquila Goods*, 11 Int'l Trade Rep. (BNA), No. 14, at 551 (Apr. 6, 1994).

[244] *See* text accompanying notes 272-292.

[245] *See* Janet Duncan, *Japanese See Trade Benefits in Mexico with NAFTA*, REUTERS, Nov. 22, 1993, *available in* LEXIS, World Library, Txtcsa File.

[246] *Mexico: Mexico's Preliminary Sept Trade Surplus $904 MLN*, REUTERS, Oct. 19, 1995, *available in* LEXIS, World Library, Txtcsa File.

[247] Thomas Black, *Peso's Fall Boosts Maquiladoras*, GANNETT, Jan. 5, 1995, *available in* LEXIS, World Library, Txtcsa File. The average labor costs account for at least 50 percent of maquiladora operation costs. *Id.* As the peso plunges, the production costs will also decrease significantly. *Id.* Therefore, the maquiladora products will become more competitive in the international market because foreign investors working with dollars in maquiladora operations are gaining considerable, unanticipated savings. *See id.*

competitiveness, many U.S. companies are moving into a "Just-in-Time" (JIT) manufacturing system, which requires their suppliers to be physically closer to their operations.[248] The maquiladora operations can also help investors to replicate the trend of the JIT manufacturing system. With Mexico's geographic advantage, foreign investors can integrate their maquiladoras into their North American customers' production sharing networks and thus, quickly respond to the manufacturing strategies of their North American customers. Their maquiladoras can be located on the U.S.-Mexico border and can carry out labor intensive production, then immediately re-export semi-finished products back to the U.S.

In general, the Mexican maquiladora program does indeed provides economic benefits to both Mexico and foreign investors. Nevertheless, the restrictive rules of origin and elimination of tariff concessions under NAFTA would make the maquiladora industry less attractive. In addition, other factors, such as infrastructure problems, inadequate supply of professional and skilled labor, and high employee turnover would also restrain the continued attractiveness of the maquiladora program.[249] Therefore, to make the maquiladora program more attractive to foreign investors, the Mexican government needs to solve these problems. Furthermore, the Mexican government has to restructure the maquiladora industry from mere export-oriented assembly to full-scale manufacturing. From this perspective, a replication of the strategies that were used in Asian NICs, such as Taiwan and South Korea, are necessary for the Mexican government to successfully move from an assembly-for-export industry to a direct manufacturing industry.

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[248] The JIT system is designed to reduce inventory to the minimal level through producing or delivering goods or services as need. JUDIE KRAJEWSKI & BARBARA RITZMAN, OPERATIONS MANAGEMENT STRATEGY AND ANALYSIS 696 (1993). Therefore, it is necessary for the suppliers to be near the plants in order to facilitate customers' JIT operation. *Id.* at 702. As the inventory has been reduced, the production costs will also be reduced, and thus the products will become more cost competitive. *Id.*

[249] *Mexico's Maquiladora Industry*, *supra* note 83.

IV. Using the Comparative Advantages of NAFTA

A. Economic Benefits of NAFTA

Economically, NAFTA provides its most significant advantages to North America. Economists believe the greatest gains in efficiency and growth tend to come from the integration of those nations which have greatly different labor and productivity levels, and capital market and natural resource conditions.[250] The great difference in the nations labor, capital, and natural resources markets also means a great difference in their comparative advantages, and thus, the possibility for economic efficiency and growth in the integration of these nations tends to be extremely large.[251] Building upon this theory, the possibility for NAFTA to reach great aggregate gains is very large because contracting countries have considerably different levels of labor, capital, and natural resources. Several studies also support the conclusion that NAFTA is likely to produce net aggregate gains for each of the member countries in both the short and long term.[252] An empirical evaluation from the International Trade Commission generally estimated that the U.S. and Canada would have long term gains with a 0.5 percent real GDP growth.[253] Similarly, Mexico is projected to experience a 0.1 to 11.4 percent real GDP growth.[254]

NAFTA, like other free trade agreements, would also lead to

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250 RICHARD S. BELOUS & JONATHAN LEMCO, NAFTA AS A MODEL OF DEVELOPMENT 4 (1993); *see also* PAUL R. KRUGMAN & MAURICE OBSTEFELD, INTERNATIONAL ECONOMICS: TRADE AND POLICY 24-27, 110, 114 (1991).

251 *Id.*

252 These studies include a report compiled by the United States International Trade Commission. U.S.I.T.C., Potential Impact on The U.S. Economy and Selected Industries of The North American Free-Trade Agreement, Investigation No. 332-337. USITC Publication 2596. 7 (Jan. 1993) [hereinafter U.S.I.T.C., Selected Industries]. The report is prepared by the U.S.I.T.C. at the request of Congress to weight the benefits of NAFTA among the three players involved and support such conclusion. *Id.* The Washington D.C. based Institute for International Economics also reached the same result. *See* GARY CLYDE HUFBAUER & JEFFREY J. SCHOTT, NAFTA: AN ASSESSMENT (1993); Timothy J. Kehoe, *Assessing The Economic Impact of North American Free Trade*, *in* THE NAFTA DEBATE 21, 30-33 (M. Delal Baer & Sidney Weintraub eds., 1994).

253 U.S.I.T.C., Selected Industries, *supra* note 252.

254 *Id.*

trade creation and trade diversion.[255] According to mainstream economic theory, the establishment of a regional trading bloc, such as a free trade area or customs union, is based on the principle of preferences.[256] The nations within the bloc have advantages that are not granted to nations outside the bloc. Therefore, regional trading bloc member countries may veil their protectionism nature through practicing discriminative preferences, such as tariff and non-tariff barriers, to non-member nations.[257] This practice leads to both trade creation and trade diversion.[258]

For trade creation effects, Mexico may benefit from the elimination of tariffs and non-tariff barriers to trade, such as quotas, licenses, and technical barriers, and thereby easily access the free-trade bloc and free flow of its products through the North American market. It can also enjoy the important dynamic effects on the increasing free-trade market, such as stimulation of technical change, stimulation of investment, and economies of scale.[259]

In addition, NAFTA further magnifies the strength of Mexico's comparative advantages and thereby undermines its competitors in the North American market. The discriminative nature of the free trade bloc will become exaggerated if interest groups within the region deliberately pursue protectionist policies, such as rules of origin, quotas, and special sanitary or phytosanitary regulation. Therefore, the trade diversion will be amplified in order to yield more production within the region.[260] NAFTA unavoidably follows this paradigm and will have trade

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255 Trade creation occurs when the removal of trade barriers leads to new trade of goods and services among members of the trading bloc that previously did not occur and trade creation leads to the positive, efficient result of free trade. Richard H. Steinberg, *Antidotes to Regionalism: Responses to Trade Diversion Effects of the North American Free Trade Agreement*, 29 STAN. J. INT'L L. 315, 320 (1993). In contrast, trade diversion occurs when the formation of the preferential trading bloc merely diverts trade away from nonmembers to members of the trade bloc. *Id.* It will have an adverse impact on nonmembers of the trade bloc and will lead to less efficiency and welfare. *Id.*

256 RICHARD S. BELOUS & REBECCA S. HARTLEY, THE GROWTH OF REGIONAL TRADING BLOCS IN THE GLOBAL ECONOMY 4 (1990).

257 *Id.*

258 Steinberg, *supra* note 255.

259 *Effects on Trade with Nonmember Countries*, 3 MEX. TRADE & L. REP. No. 3, Mar. 1, 1993, *available in* LEXIS, World Library, Mtlr File.

260 Steinberg, *supra* note 255, at 322-23.

diversionary effects in the Caribbean region, other Latin American countries, and Asia. The hardship of protectionist mechanisms under NAFTA inevitably blunts non-NAFTA exports in the NAFTA market. Even though some of these countries enjoy special tariff treatments, such as duty free export to Mexico's northern neighbors, the removal of trade barriers to imports from Mexico has undermined their receiving special treatment in the North American market.[261]

The undermining of extra-regional competitors can be seen in the example of the Caribbean Basin Initiative (CBI) countries.[262] The elimination of trade barriers under NAFTA causes significant tariff and quota disparities between Mexico and CBI countries. This disparity unavoidably depreciates the assets of the CBI and places the CBI countries at a competitive disadvantage in terms of access to the U.S. markets. The World Bank has estimated that 36 percent of Caribbean exports to the U.S. will be potentially displaced by NAFTA.[263] The U.S. has also identified that NAFTA would result in severe repercussions for the economies of CBI nations and, therefore, the U.S. intends to grant CBI beneficiaries NAFTA-like tariff and import quota treatment.[264] Nevertheless,

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[261] U.S.I.T.C., Review of Trade and Investment Liberalization Measures by Mexico and Prospects for Future United States-Mexican Relations., Phase II: Summary of Views on Prospects for Future United States-Mexican Relations, Investigation No. 332-282, U.S.I.T.C. Pub. 2326.5 (Oct., 1990) [hereinafter U.S.I.T.C., Phase II: Summary of Views].

[262] In 1983, the U.S. Congress passed the Caribbean Basin Economic Recovery Act, Pub. L. No. 98-67, 97 Stat. 369 (1983), to implement President Reagan's Caribbean Basin Initiative. 19 U.S.C. § 2701 (1988). The legislation is designed to promote the revitalization and expanded private sector opportunities in the Caribbean Basin region. The centerpiece of the act is the unilateral provision of trade preferences for a wide range of U.S. imports from the region.

[263] Richard L. Bernal, *From NAFTA to Hemisphere Free Trade; North American Free Trade Agreement*, COL. J. WORLD BUS. 22, 25 (1994).

[264] The U.S. Congress has introduced a bill to upgrade CBI by way of the Caribbean Basin Free Trade Agreement Act. *Gibbons Urges Consideration of Bill to Protect Caribbean Nations From NAFTA*, 10 Int'l. Trade Rep. (BNA) No. 26, at 1080 (June 30, 1993); *Caribbean Says Parity with Mexico on Textile Trade is a Necessity*, 11 Int'l Trade Rep. (BNA), No. 50, at 1956, (Dec. 21, 1994). This act would aim at protecting CBI beneficiaries from the possible adverse effects of NAFTA. *Id.* In addition, the Clinton Administration has also decided to seek congressional approval for an Interim Trade Program for the countries of the Caribbean Basin. *Id.* The Interim Trade Program also tends to give CBI nations NAFTA-like treatment in the area of textile and apparel. *Id.*

the proposal of giving CBI parity treatment has not reached consensus in the U.S. Congress and, therefore, whether CBI nations can enjoy parity treatment is still uncertain.[265] Assuming CBI beneficiaries will enjoy parity treatment with Mexico, they still cannot compete with Mexico in the future. This lack of competitiveness occurs because Mexico's inexpensive labor, energy, transportation costs and the economies of scale will still pose strong competitive advantages over the CBI countries.

With the undermining of its extra-regional competitors, Mexico will attract more foreign investors to move their North American production bases into Mexico. As the production bases start to operate, intra-regional trade between Mexico and its NAFTA partners is likely to increase substantially, a result which can already be seen in the recent trade performance within the NAFTA parties. The overall level of Mexico's trade with the U.S. increased by 18.4 percent in the first half of 1994.[266] Trade with Canada also increased by 42 percent in the first five months of 1994.[267] Furthermore, the sharp devaluation of the Mexican peso will further make Mexican products more competitive in the NAFTA market.[268]

More importantly, NAFTA can help Mexico to create a stable economic environment that will encourage long-term private investment in Mexico. The stability of Mexico's investment environment could be achieved in the following ways. First, NAFTA would reinforce the Mexican government's effort to continue its ongoing market-oriented economic reforms.[269] The continuation of these reforms will ensure Mexico's real annual growth and its falling rates of inflation. NAFTA will also shield Mexican products from protectionist tendencies of its northern neighbors - tendencies which fluctuate with the business cycle and

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[265] *House Democrats Ask President Clinton To Keep CBI Parity Proposal Off Table*, 13 Int'l Trade Rep. (BNA) No. 1, at 7 (Jan. 3, 1996).

[266] ECONOMIST INTELLIGENCE UNIT, COUNTRY REPORT: MEXICO 24 (4th quarter 1994).

[267] *Id.*

[268] *See supra* note 57 and accompanying text.

[269] Timothy J. Kehoe, *Assessing The Economic Impact of North American Free Trade*, *in* THE NAFTA DEBATE 21 (M. Delal Baer & Sidney Weintraub eds., 1994).

are sensitive to a variety of special interest groups.[270] Moreover, NAFTA will lead to a more predictable business environment, reducing risks associated with investment and other business decisions in the North American market.[271] As a result, the establishment of NAFTA has created a favorable investment climate in Mexico.

B. Elimination of Tariffs

Within fifteen years after its effectiveness, the NAFTA text provides for the elimination of all tariffs currently applicable to goods traded among the NAFTA partners.[272] At the end of fifteen years, all products traded within the NAFTA market will be entitled to duty-free entry if they meet the NAFTA origin rules.[273]

1. Staged Reduction of Import Duties

NAFTA prohibits the Parties from increasing existing tariffs or adopting any tariffs on an originating good except as provided by NAFTA.[274] NAFTA also phases out customs duties on originating goods over certain time periods consistent with the Parties' Schedule to Annex 302.2, or as indicated in Annex 300-B.[275]

Generally, NAFTA continues the duty-free status of products which existed before NAFTA's establishment. In addition, NAFTA immediately reduces tariffs to zero on a significant proportion of imports between NAFTA partners.[276] The tariffs on most products will also be eliminated linearly over a period of five to fifteen years.[277] The length of the tariff elimination of a particular product depends on how sensitive this product is to the respective country.[278] In general, the more sensitive the product is

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[270] *Id.*

[271] *Id.*

[272] *See infra* notes 274-85 and accompanying text.

[273] *See infra* note 293-331 and accompanying text for a discussion of country of origin rules.

[274] NAFTA, *supra* note 1, art. 302.1

[275] *Id.* annex 302 (2).

[276] *Id.* annex 302.2 § 1, (a-e).

[277] *Id.*

[278] *Id.*

considered to the respective party, the longer the phase-out period.[279] The longest period is fifteen years.[280] For example, U.S. tariffs on ceramic tile and most household glassware will be eliminated within a fifteen-year period.[281] The base rates under the tariff elimination schedule are those tariff rates generally in effect on July 1, 1991, including rates under the U.S. GSP program and the General Preferential Tariff of Canada.[282]

Certain particularly sensitive products, such as sugar and syrup goods, are subject to tariff rate quotas under NAFTA.[283] These tariff rate quotas give two levels of tariff rates. They allow a limited amount of the product to access the U.S. market at a reduced rate (the "in-quota" tariff rate), while a higher duty rate (the "over-quota" tariff rate) applies to any portion exceeding the quota.[284] Both of these level tariff rates are then reduced over a fixed period.[285]

2. *Elimination of Duty Drawback Program*

NAFTA countries have various customs programs that generally enable companies to avoid duties by providing for the refund or waiver of duties upon the exportation of goods which contain duty paid components. These programs include the U.S. duty drawback,[286] and Mexico's Pitex, Altex, and maquiladora programs.[287] The rationale behind the duty drawback program or similar devices is to encourage exports by making import inputs immune with respect to duties in order to increase manufacturers' cost competitiveness in the foreign market.[288]

NAFTA does not immediately eliminate the Parties' individual

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279 *Id.*

280 *Id.*

281 *Id.*

282 *Id.* annex 302.2 § 3.

283 *Id.* annex 703.2 § 4.

284 *Id.* art. 708.

285 *Id.*

286 Tariff Act of 1930, 19 U.S.C.A.§ 1313 (a).

287 U.S.I.T.C., Selected Industries, *supra* note 252, at 128. The programs of Altex and Pitex provide different benefits to exports based on the percentage of their total sales exported. *Id.*

288 RUTH F. STURM, CUSTOM LAW AND ADMINISTRATION 148 (1980).

duty drawback and similar programs. Rather, it suspends the termination of these programs by January 1, 2001.[289] Once the existing programs are eliminated, NAFTA will implement a uniform principle to eliminate the double payment of duties to two parties on goods which are not the NAFTA-originated goods.[290] The amount of duty refund paid under NAFTA should not exceed the lesser of: (1) the total amount of customs duties paid or owed on the non-NAFTA input for goods subsequently exported to a NAFTA country; or (2) the total amount of customs duties paid to that NAFTA party on the good when it is exported to that party.[291]

The elimination of the duty drawback program is one of NAFTA's mechanisms for avoiding free-riders of the preferential tariff treatment. It has the purpose of eliminating the incentive for producers to source from non-NAFTA inputs rather than NAFTA inputs. Since NAFTA-originated goods can be shipped duty-free between the NAFTA countries, the double taxation problem is eliminated. Therefore, there is no need for duty drawback.[292]

C. *Restrictive Rules of Origin*

Rules of origin have assumed critical importance not only in the battle over preferences, but also in the fight for market entry. NAFTA's origin rule requires a higher regional content in order to effectively encourage the use of NAFTA inputs.[293] To gain a competitive advantage under NAFTA, business people would be likely to source originating NAFTA materials. The higher regional content also increases the difficulty for foreign products to access the NAFTA market. These origin rules can also increase the competitiveness of NAFTA's products and help economic growth within the free-trade area. Therefore, rules of origin can serve as an important mechanism to safeguard NAFTA economy's prosperity. As a result, business people need to understand how

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289 The effective date for U.S.-Mexico and Canada-Mexico trade is January 1, 2001. NAFTA, *supra* note 1, annex 303.7(A)(a)-(c).

290 *Id.* art. 303.1

291 *Id.*

292 Irwin P. Altschuler & Claudia G. Pasche, *The North American Free Trade Agreement: The Ongoing Liberalization of Trade with Mexico*, 28 WAKE FOREST L. Rev. 7, 22 (1993).

293 *See infra* notes 307-29 and accompanying text.

the nationality of their products will be defined under NAFTA to ensure that the products produced in Mexico will be shielded by the protectionism under NAFTA.

1. The Policies Behind the Rules of Origin

NAFTA designs the elaborate origin rules to disguise its protection of selected sectors of the economy and its promotion of the relocation of the manufacturing process to within the NAFTA area. These origin rules have their critical importance to NAFTA partners because the NAFTA parties intend to ensure that businesses can increase their sourcing from the NAFTA region while accessing this free-trade market.[294] Its purpose is also to prevent Mexico, with its low labor costs, from becoming an "export platform" for goods entering the U.S. and Canada, that are comprised of a majority of non-NAFTA materials.[295] The NAFTA parties who want to ensure the reduced tariffs available under NAFTA will only benefit from those products which were produced through significant manufacturing or other economic activities in the NAFTA market.[296] Therefore, rules of origin become the mechanism to prevent the possibility of non-NAFTA imports from being shipped between the NAFTA partners to escape a higher tariff and exploit a lower tariff. It also prevents foreign companies from benefiting from the minor processing or trans-shipment of non-NAFTA goods.[297]

2. General Mechanisms of the Origin Rules

A good can qualify as having a North American origin and enjoy the preferential treatment under NAFTA if the good meets certain tests. First, the good will be considered to originate in the territory of a NAFTA party if the good is "wholly obtained or

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[294] Joseph A. LaNasa III, *Rules of Origin under the North American Free Trade Agreement: A Substantial Transformation into Objectively Transparent Protectionism*, 34 HARV. INT'L L.J. 381, 383-84 (1993).

[295] Donald Harrison & Kenneth G. Weigel, *Customs Provisions and Rules of Origin Under the NAFTA*, 27 INT'L LAW 654 (1993).

[296] Stephen P. Jacobs, *The NAFTA: Exports, Jobs, Wages, and Investment*, BUS. AM., Oct. 18, 1993, at 3-4.

[297] Harrison & G. Weigel, *supra* note 295.

produced in the territory of one or more of the Parties."[298] To meet the requirements for this test, the goods may not contain ingredients or components from third countries.[299] Under this definition, items such as mineral products, agricultural products, and fish products would be included.[300]

Second, goods will be considered to be of North American origin if they are produced entirely in one or more of the NAFTA countries "exclusively from originating materials."[301] Therefore, a product can combine components and processes from Mexico, Canada, and the United States to meet the requirements of this clause. However, if products underwent a process or contained any parts from a third country, the products would not meet the requirements of this provision.

Third, a product can be regarded as North American origin if the product has undergone a change in tariff classification.[302] This change in the tariff classification requirement is derived from the CFTA test.[303] It allows a good containing nonoriginating materials to qualify as a North American good if each non-originating material used in the production of the good undergoes a change in tariff classification and such production occurs entirely within the NAFTA area.[304] NAFTA defines changes of tariff classification by reference to changes in the HTS.[305] It also embodies a 168-page appendix in Annex 401 to provide specific rules for individual HTS chapters.[306]

Fourth, some specific origin rules in Annex 401 require a regional value calculation in certain products in order to qualify for NAFTA preferential treatment.[307] This condition includes cases where NAFTA requires that certain products satisfy the

298 NAFTA, *supra* note 1, art. 401(a).

299 *Id.* art. 415

300 *Id.*

301 *Id.* art. 401(c).

302 *Id.* art. 401(b).

303 Harrison & Weigel, *supra* note 295, at 654.

304 NAFTA *supra* note 1, art. 401(b).

305 LaNasa , *supra* note 294, at 388.

306 NAFTA *supra* note 1, art. 401(b).

307 *Id.* art. 401(d).

specified percentage of regional value-content calculation in addition to the tariff classification test. These products include certain types of chemical, plastic, footwear, machinery, electronic, and automotive products.[308] In addition, some products can never meet the change in tariff classification test even though they contain only a small portion of non-originating materials.[309] This situation occurs because the HTS classifies certain products in the same category as their unassembled parts.[310] Therefore, assembly of such products still remains in the same tariff classification. The regional value content test, however, provides the mechanism for dealing with such circumstances.[311]

Basically, NAFTA calculates the regional value content (RVC) of a good on the basis of either the transaction-value method or the net-cost method.[312] Under the transaction value method, regional value content is defined as a percentage equal to the transaction value of the goods (TV), minus the value of non-originating materials used by the producer in the production of the good (VNM).[313] This figure is then divided by the transaction value, multiplied by 100.[314] This can be expressed in a mathematical formula:

$$RVC = TV - VNM/TV \times 100$$

Under the net cost method, the regional value content is calculated as a percentage equal to the net cost of the good (NC), minus the value of non-originating materials used by the producer in the production of the good (VNM).[315] This figure is then

308 *Id.*

309 LaNasa, *supra* note 294, at 388.

310 *Id.* The classical example of such products is the bicycle. HTS classifies the parts of bicycle that include tires, handlebar, chain, and seat in the same category number as the bicycle. Under the change in tariff classification test, there would be no chance for the bicycle to comply with the test if it were only assembled in North America. *See id.* at 389.

311 *Id.* at 388.

312 NAFTA, *supra* note 1, art. 402 (1).

313 *Id.* art. 402 (2).

314 *Id.*

315 *Id.* art. 401(3).

divided by the net cost, multiplied by 100.[316] This translation can yield the formula:

$$RVC = NC - VNM/NC \times 100$$

NAFTA also defines these specific categories of excluded costs in Article 415. For example, it defines the "transaction value" as "the price actually paid or payable for a good or material," with the requirement that this price be "adjusted in accordance with the principles of paragraphs 1, 3, and 4 of Article 8 of the GATT Customs Valuation Code."[317] It also defines the net cost as the "total cost" minus the costs of "sales promotion, marketing and after-sales service costs, royalties, shipping and packing costs, and non-allowable interest costs that are included in the total cost."[318] In calculating the net cost, NAFTA allows the producer to use several allocation methods as long as the chosen method is consistent with Uniform Regulations on Article 511.[319]

Obviously, the two NAFTA regional content methods are different because the transaction-value cost contains some costs that are excluded in the net-cost method. The transaction-value method is based on "the price actually paid or payable for a good or material" which may include all costs and profits.[320] However, the net-cost does not include such costs as sales promotion, marketing, and shipping and packing costs, or profits.[321] To balance the difference, NAFTA imposes the transaction-value method by requiring a higher percentage of regional value content. Goods would need to contain at least sixty percent originating content under the transaction value approach. The same goods, however, would only need to contain at least fifty percent originating content under the net-cost method.[322] In addition,

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316 *Id.*

317 *Id.* art. 415.

318 *Id.* art. 415.

319 *Id.* art. 402(8).

320 *Id.* at art. 415.

321 *Id.*

322 Ralph H. Shepphard & Robert J. Leo, *NAFTA Rules of Origin-Improvement on Past Rules?*, 6 AUT. INT'L L. PRACTICUM 24 (1993), *available in* Westlaw , Inlprac File.

NAFTA requires the exporter or producer of the good to use the net-cost method to calculate the regional content value in certain circumstances, such as where the good has no transaction value.[323]

Nonoriginating materials also need to be calculated in both methods. Under NAFTA, calculating the value of nonoriginating material follows the same procedure as in calculating a material's value.[324] That is, the transaction value of a material is determined in accordance with the Customs Valuation Code.[325] Therefore, NAFTA requires that the value of the nonoriginating material should be the price actually paid or payable for such material.[326] The price of such material also includes all the costs of transportation to the sites of the producer, such as freight costs, insurance, as well as duties.[327]

Generally, the decision about whether material used by a producer is originating or nonoriginating is made on an all-or-nothing basis.[328] That is, if the material qualifies as originating under the NAFTA origin rules, then no portion of the value will be treated as nonoriginating, even if such material is comprised of partial nonoriginating submaterials.[329]

Fifth, under the de minimis rule, goods would be considered NAFTA originating products if they contain no more than seven percent of foreign content.[330] This rule appears to prevent goods comprised of foreign content, which is less than seven percent of the total cost of the goods, from losing their eligibility for the NAFTA preference. If such goods cannot meet the change in the tariff classification test or the transaction value of the good is not acceptable, they are still eligible for the preference. The rule may also be useful when a party wants to avoid the paperwork of the regional value content requirement. However, the *de minimis* rule does not apply to a number of agriculture goods or to over half of

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323 NAFTA, *supra* note 1, art. 402(5).

324 *Id.* art. 402(9).

325 *Id.*

326 *Id.* arts. 402(2), 415.

327 *Id.* arts. 402(9)(a), 402(9)(c), 415 .

328 Harrison & Weigel, *supra* note 295, at 658.

329 *Id.*

330 NAFTA, *supra* note 1, art. 405(1)-(2).

all the listed goods, unless the nonoriginating material is from a different tariff classification subheading.[331]

D. The Reduction of Non-Tariff Barriers to Trade

In addition to the elimination of tariff barriers, NAFTA also reduces or eliminates non-tariff barriers to trade. Such barriers include quotas, import licensing requirements, import price requirements, export performance requirements, as well as less specific barriers, such as customs user fees.[332] Since tariff barriers have fallen dramatically under the effort of General Agreement of Tariffs and Trade,[333] non-tariff barriers have received growing attention.[334] In many sectors, non-tariff barriers represent more effective restraints on trade than do actual tariffs.[335] Therefore, in many cases, the elimination of these non-tariff barriers under NAFTA will result in a significant improvement in market access among NAFTA countries.[336]

NAFTA requires that most existing licensing requirements be removed and prohibits the parties from implementing any new licensing requirements, except requirements that are specifically provided for in NAFTA.[337] NAFTA also requires that most quota restrictions be phased out.[338] Currently, the U.S. maintains quotas primarily on textiles, apparel, and some agricultural commodities.[339] The lifting of quotas on intra-regional trade is likely to contribute to intra-NAFTA trade in these sectors. Therefore, the imports from Mexico are very likely to increase substantially.

In addition, NAFTA also provides a new framework for

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331 *Id.* art. 405(3), (6).

332 *Id.* art. 309(2), art. 310; *see also* JOHN H. JACKSON, THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 130 (1989).

333 General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafte GATT].

334 Catherine Curtiss & Kathryn Cameron Atkinson, *United States-Latin American Trade Laws*, 21 N.C. J. INT'L LAW & COM. REG. 111 (1995).

335 Altschuler & Pasche, *supra* note 292, at 23.

336 *Id.*

337 NAFTA, *supra* note 1, art. 309(1).

338 *Id.*

339 Altschuler & Pasche, *supra* note 292, at 23.

country of origin marking regulations.[340] Country of origin marking regulations can be used as barriers to trade by imposing requirements that make trade in goods commercially difficult. To avoid marking rules being abused as a trade barrier, NAFTA generally allows the party to use any reasonable method to mark the country of origin of a specific good as long as such marking is "conspicuous, legible, and sufficiently permanent."[341] The parties are also obligated to accept marking in English, Spanish, or French, but may require that the mark accord to the same rules applicable to their own goods.[342] Additionally, NAFTA provides special rules for marking containers.[343] Under NAFTA, these rules of marking should prevent NAFTA parties from using marking requirements to severely restrict the movement of certain goods between NAFTA countries.

NAFTA, moreover, liberalized ground transportation barriers within the NAFTA countries. Cross-border trucking access throughout North America will be phased in over a period of six years.[344] The liberalization of cross-border trucking is likely to reduce transportation costs substantially for goods produced in Mexico and transported to the U.S. and Canadian markets, and therefore, make almost all Mexican products marginally more price-competitive.

Lastly, NAFTA also eliminates customs user fees for goods originating in NAFTA territory.[345] Even though the customer user fees are not significant, they can increase the cost of importation and weaken their cost competitiveness in comparison to domestic products. Under NAFTA, both Mexico and the U.S. may not increase their merchandise processing fee on NAFTA originating goods. In addition, such fees shall be eliminated by June 30,

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340 NAFTA, *supra* note 1, art. 311, annex 311. Marking an import article was first required by Tariff Act of 1890, ch. 1244, § 26 Stat. 567, 613 (1981). *See* David Silverstein, *Country-of-Origin Marking Requirements Under Section 304 of the Tariff Act: An Importer's Map Through the Maze*, 25 AM. BUS. L.J. 285 (1987).

341 NAFTA, *supra* note 1, annex 311.5(a).

342 *Id.* annex 311.3.

343 *Id.* annex 311.

344 *Id.* annex 1212.

345 *Id.* art. 310.

1999.[346]

In general, NAFTA rules of origin have made a significant improvement in determining a product's origin. The NAFTA origin rules do away with the subjective and ambiguous substantial transformation test[347] and use more objective and specific approaches. This increases their uniformity and predictability, and thus facilitates businesses in purchasing and sourcing decision making.

E. Gateway Into the Latin American Market

Today, Latin America has passed through the "lost decade"[348] and is starting to rejuvenate its economics. With the assistance of the International Monetary Fund and the World Bank, most Latin American countries are undergoing market-oriented economic adjustments.[349] Moreover, these economic adjustments often lead to democratic-oriented political reforms in these countries.[350] As the economic and political climate changes, business opportunities are rapidly emerging. A growing number of new consumers and industrial markets, abundant natural resources and expanded capital markets are now within easy reach of foreigners. To many foreign investors, the opening of Latin America has come as a surprise. Also, for the first time ever, Western Hemisphere markets rival and may surpass those in Europe and East Asia.

In recent years, the interest of regional trade liberalization has

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346 *Id.* annex 310.1.

347 The substantial transformation test was articulated in the U.S. Supreme Court's decision in Anheuser-Busch Brewing Association v. United States, 207 U.S. 556, 562 (1908). The substantial transformation test affords the customs officials and courts great subjectivity and discretion. *Id.*; *see* C. Edward Galfand, Comment, *Heeding the Call for A Predicable Rule of Origin*, 11 U. PA. J. INT'L BUS. L. 469, 471, 480, 484 (1989). This test leads to great ambiguity for business in predicting how a given good will be treated. *Id.*

348 Most Latin American countries suffered debt crisis in 1980s. Roberto Zahler, *The Background, Rationale and Success of Chilean Economic Policy*, 16 LOY. L.A. INT'L & COMP. L.J. 275 (1994). To solve the debt crisis, Latin American countries followed the recommendations from International Monetary Fund and World Bank to implement painful economic adjustments. *Id.* As a result, the 1980s are regarded as a "lost decade" for Latin American countries. *Id.*

349 *Id.*

350 Enrique R. Carrasco, *Law, Hierarchy, and Vulnerable Groups in Latin America: Towards a Communal Model of Development in a Neoliberal World*, 30 STAN. J. INT'L L. 221, 223 (1994).

resurged in Latin America. Therefore, several new regional trade liberalization and economic cooperations have been established in this region. For instance, the Southern Cone Common Market, known as "MERCOSUR," went into force on January 1, 1995.[351] This economic bloc comprises, together with Brazil, Argentina, Uruguay, and Paraguay, a market of 190 million people and $800 billion of annual production.[352] MERCOSUR also represents about half of Latin America's GDP and is the largest economic bloc in Latin America.[353]

The trend of trade liberalization and economic cooperation in Latin America is actually inspired by former U.S. President Bush's Enterprise for the Americas Initiative (EAI), which is dedicated to free trade in the Western Hemisphere.[354] The EAI did not trigger these free-trade developments, but it may have served as an impetus in the processes of trade liberalization within this region.[355] Facing the growing regionalization in Latin America, the NAFTA parties do not confine themselves to their NAFTA partners only. Instead, the NAFTA partners show a strong ambition in Latin American markets and have aggressively participated in the resurging regionalization. For example, Mexico is using the strategy of establishing free trade agreements with several countries in the region to strengthen its economic presence in the Latin American markets.[356] In particular, President Clinton's

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351 Adrian Dickson, *Brazil: MERCOSUR Launch to Spark Latin America Trade Boom*, REUTERS-CENT. & S. AM., Jan. 1995, *available in* LEXIS, World Library Txtcsa File. For further discussion on integration between Mercosur members see Marta Haines-Ferrari, *MERCOSUR: A New Model of Latin American Economic Integration*, 25 CASE W. RES. J. INT'L L. 413-15 (1993).

352 Dickson, *supra* note 351, at 413-15. The agreement went into effect on January 1, 1995 and immediately phased out 90% of the tariff barriers between the partners. *Id.* The remaining 10 percent of tariffs in the area of strategic industries such as automotive and computers will be also eliminated by 2001. *Id.*

353 *NAFTA Is Not Alone*, ECONOMIST, June 18, 1994, at 47.

354 Richard Bernal, *Regional Trade Arrangements in The Western Hemisphere*, 8 AM. U. J. INT'L L. & POL'Y 683, 689 (1993).

355 *Id.* The EAI was proposed by President Bush on June 27, 1990; *U.S. Signs Trade-Investment Pact with The Four MERCOSUR Nations; Southern Cone Common Market Nations: Argentina, Brazil, Paraguay and Uruguay*, BUS. AM., July 1, 1991, *available in* LEXIS, News Library, Asapii File.

356 *See* Anthony Boadle, *Chile: Mexico and Chile Sign Free Trade Accord on Sunday*, REUTERS, Sept. 20, 1991, *available in* LEXIS, World Library, Txtlne. Currently, Mexico has completed four free trade agreements with several Latin

economic policy toward Latin America basically replicates the EAI,[357] and stresses that the passage of NAFTA was only the beginning of the creation of free trade in the entire hemispheric market.[358] Following this policy, the movement of integrating the Pan-American market has accelerated recently. At the Summit of Americas held in December 1994, the NAFTA parties formally invited Chile to join NAFTA.[359] Along these same lines, the presidents of the United States and Brazil asked for input on potential links between NAFTA and MERCOSUR.[360] In addition, the 34 leaders in the Western Hemisphere also agreed to create a free-trade zone in the Americas by the year 2005.[361] Accordingly, the trade ministers of the Americas signed a declaration ratifying their commitment made at the Summit of Americas, as well as a plan of action to achieve this ambitious goal.[362]

The integration process in the Americas will likely provide a favorable channel for Mexican products to access the contracting countries' markets. Furthermore, as a Spanish-speaking country, Mexico shares similar social customs with most other Latin American countries. Due to this unique characteristic, business

American Countries, including Chile, Venezuela and Columbia, Bolivia, and Costa Rica. *Mexico, Chile FTA*, 1 MEX. TRADE & L. REP. No. 1, Oct. 1, 1991, *available in* LEXIS, World Library, Mtlr File; *Group of Three Agrees Program; Also Colombia & Chile, But American Deal Stalls*, LATIN AMERICA WKLY. REP., Dec. 16, 1993, *available in* LEXIS, World Library, Lan File; *Bolivia-Mexico: Businesses Welcome New Free Trade Pact*, INTER PRESS SERV., Sept. 9, 1994, *available in* LEXIS, World Library, Curnws File; *Mexico: Mexico and Costa Rica Sign Free Trade Accord*, REUTERS, Apr. 5, 1994, *available in* LEXIS, World Library, Txtcsa File. In addition, several free trade talks are underway with so-called "northern triangle," namely El Salvador, Guatemala, and Honduras. *Three Central American Countries, Mexico to Sign Accord*, XINHUA NEWS AGENCY, Jan. 4, 1995, *available in* LEXIS, News Library, Iacnws File.

357 Paul A. O'Hop, Jr., *Hemispheric Integration and The Elimination of Legal Obstacles Under A NAFTA-Based System*, 36 HARV. INT'L. L.J. 127 (1995).

358 *See, e.g.*. Secretary of Commerce Ron Brown, Remarks at Commerce Department Budget Briefing, FED. NEWS SERV., Feb. 7, 1994, *available in* LEXIS Library, Fednws File.

359 *NAFTA 'Amigos' Invite Chile to Begin Accession Talks*, 11 Int'l Trade Rep. (BNA) No. 49, at 1914 (Dec. 14, 1994).

360 *Brazil Goal of Free Trade Area of Americas by 2005 Is Feasible, Brazil's Cardoso Say*, Int'l Trade Rep. (BNA) Apr. 24, 1995.

361 James Brooke, *U.S. and 33 Hemisphere Nations Agree to Create Free-Trade Zone*, N.Y. TIMES, Dec. 9, 1994, at 1.

362 Jose Antonio Puertas, *34 Countries Push Pan-American Free Trade Zone, But Brazil Wary on Pace*, AGENCE FRANCE PRESSE, July 2, 1995, *available in* LEXIS, World Library, Curnws File.

people can also regard Mexico and the Latin American countries as a homogeneous market. Thus, Mexico can function as an important testing market for the entrance of products into the immense Latin American market. If a product can be marketed successfully in the Mexican market, it also means that it is probable that success will follow in the Latin American market. Therefore, Mexico can truly be a stepping-stone to the Latin American market.

V. Market Access in Potential Sectors

Since liberalization of sensitive industries in the NAFTA countries will take five to fifteen years, enterprises in Asian countries still have time to plan and reallocate resources in order to minimize the impact of NAFTA.[363] Therefore, Asian enterprises have to identify product sectors that will be in greater demand in the North American market due to NAFTA trade creation. Asian enterprises should especially focus on products which could be used as inputs into Mexican-assembled final products shipped for the U.S. market. This is because some Asian components will be price-competitive and their use will not disqualify Mexican-made finished products from NAFTA preferential treatment. However, this approach will require paying close attention to the restrictive rules of origin under NAFTA. Potential sectors for Asian enterprise to access the Mexico market to alleviate the impact of NAFTA market as well as the feasible market access strategies will be fully discussed below.

A. Automotive Goods

Consistent with the enormous importance of automotive manufacturing and the trade in and among NAFTA parties, NAFTA also addresses the liberalization of trade and investment in the automotive sector.[364] In general, the agreement eliminates duties, as well as the various special restrictions that apply to trade in motor vehicles and in automotive parts.[365] The agreement also

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[363] *See supra* 274-85 notes and accompanying text.

[364] *See* NAFTA *supra* note 1, ch. 3, annex 300-A.

[365] HUFBAUER & SCOTT, *supra* note 252, at 38.

prohibits the parties from imposing any new restrictions.[366] However, NAFTA still uses a higher regional content requirement to ensure the comparative advantage of the intra-regional automotive industry.[367]

NAFTA has scheduled a reduction of, and eventually the elimination of the duties on passenger cars, light trucks, minivans, and autoparts.[368] Particularly, the reduction of the twenty-five percent duty, which the U.S. currently levies on light trucks and some minivans, could lead to a greater production of these vehicles in Mexico.[369] More importantly, the removal of non-tariff barriers in this sector is likely to have its greatest impact on bilateral trade in automotive products. For instance, NAFTA requires Mexico to modify its "Decree for Development and Modernization of the Automotive Industry of 1989" to make it consistent with NAFTA before January 1, 2004.[370] This is likely to liberalize the Mexican automotive industry sector and facilitate foreign participation in this sector.

Aside from the elimination of tariff and non-tariff barriers, the most significant feature of NAFTA respective to automotive trade is that NAFTA contains a more stringent, but clear and predictable, origin ruling.[371] To qualify for NAFTA benefits, the regional value content for passenger vehicles and light trucks must be greater than 62.5 percent.[372] In addition, the regional content should be greater than 60 percent for passenger vehicle and light truck engines and transmissions, and all other vehicles and auto parts.[373] These higher requirements will be phased in through

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366 NAFTA *supra* note 1, art. 309(1).

367 *See supra* notes 294-97 and accompanying text.

368 NAFTA *supra* note 1, annex 302.2. For instance, the NAFTA will immediately eliminate U.S. tariffs on Mexico made automobiles. Hufbauer & Scott, *supra* note 252 at 38.

369 NAFTA *supra* note 1, annex 302.2.

370 *Id.* annex 300A.2.

371 Kathryn L. McCall, *What is Asia Afraid of? The Diversionary Effect of NAFTA's Rules of Origin on Trade Between the United States and Asia*, 25 CAL W. INT'L L. J. 400-01 (1995).

372 NAFTA *supra* note 1, art. 403(5).

373 *Id.*

increases in the regional value content in 1998 and 2002.[374] However, NAFTA gives new plants a five-year grace period from their start-up during which they may have only 50 percent NAFTA content.[375]

In addition, calculation of the regional value content based on the net-cost method will be strengthened somewhat by requiring the "tracing" of non-NAFTA components.[376] Automotive manufacturers need to report the value of certain non-originating materials used in components as calculated at the time the first person in a NAFTA country takes the title.[377] This traces the autoparts' origin through the production process and thereby, improves the accuracy of the content valuation.

The fairly rigid rules of origin for automotive products are designed to reduce the use of automobile components assembled among NAFTA partners but imported from non-NAFTA countries because the higher the regional value content requirement, the more value that will be generated in the NAFTA region. As a result, the automotive rules of origin will force non-NAFTA automotive companies which have already manufactured cars in North America, such as Japanese companies, to source more parts in the North American facilities. This trend may adversely affect Asian automobile parts manufacturers.

Facing the new trade rules under NAFTA, Asian automotive parts producers are advised to invest in Mexico because Mexico provides production quality and cost advantages that other existing sites in North America do not. In addition, the Mexican market represents major growth potential because the new trade rules under NAFTA will provoke abundant business opportunities in Mexico. Moreover, many Asian automotive corporations have already operated in Mexico.[378] These Asian operations,

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374 The regional value content must be 56 percent and 55 percent respectively by January 1, 1998 and 60 percent by January 1, 2002. *Id.* art. 403(5).

375 *Id.* art. 403(6).

376 *See* discussion of net-cost method, *supra* notes 315-23.

377 NAFTA *supra* note 1, art. 403.1.

378 In addition to Nissan, which is wholly operated by itself, many Asian automobile producers affiliate with the U.S. Big Three to set up operation in Mexico. *See* GRAY NEWMAN & ANNA SZTERENFELD, BUSINESS INTERNATIONAL'S GUIDE TO DOING BUSINESS IN MEXICO, 168, 171 (1993). For example, the Korean Daewoo Motors, and

particularly the Japanese-owned automotive corporations, are likely to source from Asian parts suppliers because they place substantial emphasis on maintaining long term relationships with a limited number of automotive parts suppliers.[379] This situation poses another competitive advantage for Asian automotive parts producers in Mexico. Therefore, these parts supplier need to closely coordinate with their major customers in order to successfully establish their production bases in Mexico.

B. Textiles and Apparel Goods

Textile and apparel industries are strongly protected in North America, particularly in the United States. Imports of this sector were subject to both quotas and relatively high tariffs under the Multifiber Arrangement (MFA).[380] For instance, the U.S. imposes a twenty percent tariff on textiles, a figure much higher than the four percent tariff on all imported goods.[381] Although from January 1, 1995, the quota system under MFA will be phased out over 10 years under the World Trade Organization (WTO) Agreement on Textiles and Clothing,[382] this WTO Agreement on Textiles and Clothing also imposes new safeguard mechanisms and restrictive disciplines on transshipment and monitoring.[383] In addition, import duty on textiles remains subject to individual WTO member's tariff schedules.[384] As a result, the Textiles Agreement is not likely to ease the import restraints of foreign

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Kia Motors have made the Pontiac LeMans for GM and Festiva for Ford. *Id.* at 171. In addition, Isuzu cooperates with GM to build the Geo brand, Mazda with Ford to build the Tracer, and Mitsubishi and Chrysler produce pickups under both names in Mexico. *Id.*

379 U.S.I.T.C., RULES OF ORIGIN ISSUES RELATED TO NAFTA AND THE NORTH AMERICAN AUTOMOTIVE INDUSTRY, Investigation No. 332-314, U.S.I.T.C. Pub. 2460.13-14. (Nov. 1991).

380 Agreement Regarding International Trade in Textiles, Dec. 20, 1973, 25 U.S.T. 1001.

381 Janet Patrica Farmer, *NAFTA and The Textile and Apparel Industries: Made in North America*, 19 N.C. J. INT'L L. & COM. REG. 299 (1994).

382 Article 9 of the Agreement on Textiles and Clothing, annex 1A, Agreement Establishing the World Trade Organization, Apr. 15, 1994, reprinted in H.R. Doc. No. 316, 103d Cong., 2d. Sess. 1396 (1994) [hereinafter Textiles Agreement.]

383 *Id.*

384 David A. Gantz, *A Post-Uruguay Round Introduction to International Trade Law in the U.S.*, 12 ARIZ. J. INT'L & COMP. LAW 101 (1995).

textiles and apparels in the North American market.[385]

Under NAFTA, the parties will phase out their duties on originating textile and apparel within a maximum of ten years.[386] In response, the U.S. immediately terminated the import quotas on qualifying textiles from Mexico when NAFTA took effect.[387] Thereafter, no quotas have applied to textile and apparel goods originating in NAFTA territory.

To enjoy the full benefits of NAFTA, textiles and apparel companies need to comply with the restrictive rules of origin requirement. NAFTA excludes the origin rules of textiles and apparel from the regional value content requirements.[388] Instead, textiles and apparel are subjected to a more restrictive regime. The textile origin rules, known as yarn-forward rule, require that the yarn used in the manufacture of the good be produced within the treaty region.[389] The yarn-forward rule is a triple transformation test because it requires that the yarn be produced, the fabric made, and the clothing sewn in the NAFTA area.[390] NAFTA also allows some exceptions to the yarn-forward rule. Certain materials, such as wool, which are in short supply or not produced in North America, can also receive preferential treatment under NAFTA without complying with the yarn-forward rule, as long as the good made from that fabric is cut and sewn in the NAFTA countries.[391]

As in the situation involving automotive products, the rationale

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385 Many Asian textiles suppliers have worried that the Textiles Agreement will further restrain their exports to the North American market. Frances Williams, *Fruits of Textiles Pact Fail to Ripen—Poor Nations Have Yet to See Benefits from Accord*, FIN. TIMES, Jan. 10, 1996, *available in* LEXIS, World Library, Allwld File; Such worries have been emphasized by 24 U.S. quota calls in 1995. *Id.* According to these quota calls, the U.S. government imposed new restrictions on 14 developing countries in Asia and Latin America under the safeguard clause of the Textile Agreement. *Id.* In addition, the Hong Kong government predicted that a reduction of its textile and apparel exports is likely to reach $41 billion HK due to the new Textile Agreement. *See* Amy Chew, *China: Full Implementation Set to Increase Exports by 26.5 PC*, S. CHINA MORNING POST, Dec. 26, 1994, *available in* LEXIS, World Library, Txtfe File.

386 NAFTA, *supra* note 1, ch. 3 (scheduled to annex 302.2); annex 300-B, app. 2.1, and app. 3.1 (B); *see also* U.S.I.T.C., Selected Industries, *supra* note 252, at 225.

387 NAFTA, *supra* note 1, ch. 3.

388 *Id.* art. 401(d).

389 U.S.I.T.C., Selected Industries, *supra* note 252, at 253.

390 NAFTA, *supra* note 1, ch. 4, annex 401, XI.

391 *Id.* ch. 4, annex 401.

of using the yarn-forward rule is to eliminate quotas and tariffs as an incentive to encourage the producers to buy North American fabrics.[392] However, this NAFTA protection mechanism in textile and apparel sectors is likely to impede the competitiveness of Asian products in the NAFTA market and therefore have a strong impact on Asian exporters.[393] In addition, labor costs are critical in product competitiveness because this sector is labor intensive.[394] Major Asian exporters are confronting several disadvantages, such as restrictive quotas in the U.S., restrictive export growth under the Textile Agreement, and rising production costs in their home countries.[395] Facing these adverse factors, Asian producers may, therefore, consider establishing their North American production base in Mexico to take advantage of abundant and cheap Mexican labor, and the elimination of quotas and tariffs under NAFTA.

C. *Computers and Computer Peripherals*

NAFTA is not likely to increase U.S. imports of Mexican computers and computer peripherals in the short run. However, because the assembly of computer and computer peripheral is labor intensive,[396] NAFTA, in the long term, may impact Asian countries, such as China and Thailand, which specialize in low-end computer product assemblies or subassemblies.[397] This is because NAFTA will divert trade and investment to Mexico from these Asian countries. In addition, rules of origin under NAFTA,

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392 *See* LaNasa, *supra* note 294, at 398.

393 The market shares of Far Eastern textile and apparel imports in the U.S. dropped to 55.7 percent in 1994, down from 58.7 percent of 1993 levels. *See 1994 Overall Deficit Up 43 Percent; Merchandise Trade Gap Hit $166 Billion*, 12 INT'L TRADE REP. (BNA) No. 8, at 332 (Feb. 22, 1995). On the other hand, in 1994, Mexican textile and apparel products grew 31 percent over 1993 levels. *See Mexican Apparel and Textile Exports to U.S. See Jump under NAFTA, ITC Says*, 12 INT'L TRADE REP. (BNA) No. 19, at 815 (May 10, 1995). Currently, Mexico is tailing China, Hong Kong, Taiwan, and South Korea and ranked the fifth largest supplier in the U.S.. *Id.*

394 Labor comprises more than 31% of total apparel production costs, and more than 21% in textile production. Farmer, *supra* note 381, at 297.

395 Hong Kong, Taiwan, and South Korea are the big three Asian suppliers in the U.S. *Mexican Apparel*, *supra* note 393. Currently, Hong Kong, Taiwan, and South Korea are experiencing rising production costs, and China is facing restrictive quotas. U.S.I.T.C., Selected Industries, *supra* note 252, at 262.

396 U.S.I.T.C., Indus. & Trade Summ., Computers, Peripherals, And Computer Components, U.S.I.T.C. Pub. 2821.4 (Oct. 1994) [hereinafter U.S.I.T.C., Computers].

397 *See* U.S.I.T.C., Selected Industries, *supra* note 252, at 203.

are relatively lenient towards computer products.[398] This lenient requirement enables personal computers to be assembled in the NAFTA region using all nonoriginating components and still enjoy NAFTA's preferential treatment, as long as the motherboard is made in North America. Mexico's competitive labor cost combined with NAFTA's relatively liberal rules of origin and phase out of tariffs will result in Mexican computer products posing a strong threat to Asian computer products in the long term.

Furthermore, as Mexico strives to modernize itself, the Mexican market for computers and peripherals holds potential for Asian computer companies, because a growing number of Mexican companies need computers to carry on their daily operations. The market is also receptive to new computer equipment. Computer literacy is growing in Mexico and, therefore, the Mexican market has been regarded as one of the fastest-growing computer markets with an expected annual growth of 24 percent in the next two years.[399]

Since Mexico's computer market is rapidly growing, Asian computer enterprises need to enter this market as soon as possible in order to take advantage of increasing business opportunities. Admittedly, directly marketing their products into the market through their own efforts could involve much time, costs, and risks. In particular, many Asian computer enterprises are small and medium size companies and only have limited capital and marketing resources. Therefore, directly marketing products by themselves is not likely an appropriate approach for Asian enterprises to penetrate Mexico's computer market.

Nevertheless, Asian computer makers, particularly Taiwanese-owned producers, are known for their cost competitiveness.[400] Their management approach is focused on a lean, flexible design-

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[398] NAFTA rules of origin only requires the motherboard, which is defined as circuit board with a central processing unit or microprocessor, is North American in origin.

[399] Sali Tripathi, *High-Tech Rebound*, ASIA INC., Feb. 1995, *available in* LEXIS, World Lib. Allwld File. In addition, another report also predicts that the Mexican computer market will have continuing growth in next five years. *Mexico-Computers and Peripherals*, MARKET REP., Mar. 21, 1995, *available in* LEXIS, World Library, Mktrpt File; *see also* U.S.I.T.C., Computers, *supra* note 396, at 46.

[400] Mark Clifford, *Power Switch*, FAR E. ECON. REV., Dec. 16, 1993, at 44-45.

and-manufacturing style, which enables them to change and complete the designs rapidly as well as to slash costs to the bone.[401] Thus, many Asian-made computer components, such as motherboards, image scanners, monitors, key boards, and mice, have significant market shares in the global market.[402] To successfully penetrate the speedily-growing Mexican computer market and gain strong footholds in it, Asian computer companies must utilize their design and manufacturing strengths. A successful strategy used by Acer, the largest Taiwan computer maker, can be replicated by Asian computer makers. Acer strategically allied[403] itself with a Mexican firm, Compute, which has a strong marketing and distribution channels in the Mexican market.[404] As mentioned above, the assembly of computer and computer peripheral is labor intensive, therefore, Acer first set up a maquiladora type of assembly operation in Mexico to benefit from the low cost Mexican labor.[405] Then, Acer utilized its modular design, packaging, and assembly technique, a method to ensure the swift delivery of high quality and advanced PCs, while maintaining low inventory levels.[406] This strategic alliance has allowed Acer to supply "fresh" PCs directly and in a timely manner to the Mexican market.[407] On the other hand, Compute provides its marketing and distribution strengths, clear knowledge

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401 *Id.*

402 For instance, the global market shares of Taiwan-made notebook PCs was 22%, image scanners 55 percent, monitors 51 percent, motherboards 83 percent, switching power supply 30 percent, keyboard 49 percent, and mice 80 percent in 1993. *Taiwan's Computer Industry; Inside the Box*, ECONOMIST, July 9, 1994, at 65.

403 Strategic alliance is a type of business cooperation that allows different corporations to work together in order to achieve their strategic purpose. *See* Industrial Development & Investment Commission, *Ju Ho Chia Ciang Chung Hsiao Ch'i Yeh Chin Hsing Ts'è Lüeh Lien Meng*, (How to Enhancively Assist Small and Medium Size Enterprises to Approach Strategic Alliance) INDUS. INVESTMENT BRIEF, Feb. 1994, at 10-11. The alliance is not limited to a traditional type of joint venture for the cooperation, but can also be based on a non-equity oriented cooperation, such as a long term supply contract, or technology cooperation. *Id.* In addition, the alliance does not focus on full-scale cooperation, but rather focuses on an integration of different value-added activities in a specific market. *Id.*

404 *Acer Forms Fifth Regional Business Unit; Joint Venture with Long-Term Mexico Partner to Boost Latin American Presence*, BUS. WIRE, June 14, 1994.

405 *Id.*

406 *Id.*

407 *Id.*

of local requirements, broad financial resources, and outstanding management team to market and distribute Acer's computer and peripheral products.[408] As a result, within three years the strategic alliance has enjoyed great achievements and now commands the largest market share, 29 percent, in the Mexican market.[409]

D. Telecommunication Equipment

In addition to the computer market, Asian enterprises can also initiate strategic alliances in Mexico's telecommunication market, since the telecommunication market shares a character similar to that of Mexico's computer market. Business opportunities in the Mexican telecommunication sector are also expected to experience significant growth.[410] Much of this growth has been spurred by the privatization of Mexican telecommunications system initiated in 1990.[411] Through successful privatization of its state-owned telephone company, TELMEX, in 1991,[412] the telecommunication sector in Mexico has received large inflows of resources to finance Mexico's modernization and expansion of its telecommunication network.[413] As the expansion of the telecommunication network continues, the demand for telecommunication equipment is likely to increase. In addition, the implementation of NAFTA will also lead to a growth of demand in telecommunication equipment and services. As many investors move into the Mexican market, the demand for all kinds of telecommunication equipment and services, such as telephone apparatus, and facsimile machines, will increase significantly. Currently, Mexico has no more than 8 lines per 100 inhabitants.[414] Since the supply of telecommunication

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[408] *Id.*

[409] *Computer Market Trend*, 5 MEX. TRADE & L. REP. No. 5, June 1, 1995, *available in* LEXIS, World Library, Allwld File.

[410] *See infra* notes 411-14 and accompanying text.

[411] The new ownership of TELMEX is represented by a consortium formed by France Telecom, Southwestern Bell, and a group of Mexican investors, and minority participation of the Mexican government. Gabrie Azekely and Oscar Vera, *What Mexico Brings to the Table: Negotiating Free Trade with the U.S.*, COLUM. J. WORLD BUS., June 22, 1991. Under the privatization terms, TELMEX obtained a five year concession to supply telephone service as a regulated monopoly. *Id.*

[412] *Id.*

[413] *Id.*

[414] U.S.I.T.C., Indus. & Trade Summary, Telecommunications Equipment,

services is insufficient and there is a strong demand for such services, this deficiency indicates plenty of growth potential for all segments of the telecommunication market.[415] These developments also represent continued and expanding opportunities for Asian enterprises.

Like the Asian computer industry, many Asian telecommunication equipment producers have been famous for producing cost-competitive technology in the middle-level range of telecommunication equipment. Production of switchboards, telephone apparatuses and facsimile machines have enabled them to become some of the major suppliers among world-renowned telecommunication companies.[416] Therefore, Asian enterprises should utilize this strength and function as suppliers of telecommunication equipment in the Mexican market. They can ship semi-finished products and components to their Mexican maquiladora plants for final assembly. By taking advantage of Mexican low-cost labor and the manufacturing experience of Asian enterprises, they can also produce cost-competitive and high quality products in Mexico, and market them to the Mexican market.

However, to quickly and effectively secure important roles in the growing Mexican telecommunication market, Asian enterprises need to build a strategic alliance with main players in the market. Under the privatization terms, TELMEX obtained a five-year concession to supply telephone service as a regulated monopoly.[417] This also means that by 1997 TELMEX will be the major consumer of telecommunication equipment. Therefore, to

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U.S.I.T.C. Pub. 2820. 46 (1994).

415 Although the economic setback in 1995 is likely to decrease the growth of the Mexican telecommunication market by 21 percent, the growth is expected to resume at an average rate of 5 percent in 1996 and 1997. *See Telecommunication*, MEX. TRADE & L. REP., May 1, 1995, *available in* LEXIS, World Library, Mtlr File.

416 For example, in 1994, Taiwan's telecommunication industry has the fourth largest production worth in the world, and it has become the major source for telecommunication products since 1991. *See Taiwan: Taiwan is Now A Major Source for Telecommunications Products*, BUS. TAIWAN, Sept. 23, 1991, *available in* LEXIS, World Library, Txtfe File; *Taiwan: Press Digest*; *Taiwan Newspapers-Nov 7*, REUTERS, Nov. 7, 1995, *available in* LEXIS, World Library, Txtfe File.

417 Howard LaFranchi, *Competition Lines Up for Long Distance Operating in Mexico*, CHRISTIAN SCI. MONITOR, Oct. 4, 1994, *available in* LEXIS, World Library, Allwld File.

strengthen their roles in the Mexican market, Asian enterprises should seek to strategically ally themselves with TELMEX in order to have access to the Mexican market as important suppliers. Similarly, in the long-term, they should seek the same approach with their existing North American customers or other large telecommunications service providers, such as the Bell regional operating companies in the U.S., which are expected to expand their local service networks as well as enter the equipment market this decade.[418]

E. Machine Tools

Traditionally, the U.S. market is an important export destination for Asian machine tools.[419] However, the major Asian machine tool makers, Japan and Taiwan, were subject to a voluntary restraint agreement (VRA) imposed by the U.S. government which limited their development in the U.S. market.[420] Although the VRA was terminated in the end of 1993, it has not been easy for Asian machine tool manufacturers to regain their position in the U.S. market because the U.S. machine tools industry has improved their international competitiveness in the past seven years.[421] In addition, the appreciation of the Yen and the new Taiwan dollar, and the shortage of labor, have deteriorated the price-competitive position of Taiwanese and Japanese machine

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[418] DRI/ MCGRAW-HILL, *supra* note 4, at 10.

[419] For example, the U.S. market currently is Taiwan's second largest export destination absorbing the island's 21 percent of total machine tools exports. *See Taiwan: Machine Tool Imports and Exports See Sold Growth*, BUS. TAIWAN, Oct. 16, 1995, *available in* LEXIS, World Library, Txtfe File. However, with the lift of voluntary restraint agreement with the U.S., the U.S. is expected to take over Hong Kong as the largest export outlet for Taiwanese machine tools. *Id.*

[420] In 1986, the U.S. Reagan administration negotiated with the Taiwan and Japanese governments on exports of machine tools to the U.S.. *See* Ben Shen, *Taiwan: Machine Tool Manufacturing—An End to 'Voluntary Restraint'*, BUS. TAIWAN, Jan. 24, 1994, *available in* LEXIS, World Library, Txtfe File; *Japan: MITI to Terminate Machine Tool VRA in December*, COMLINE, Sept. 7, 1993, *available in* LEXIS, World Library, Txtfe File. As a result, the three governments agreed to five years of voluntary restraint agreements (VRA). *Id.* Nevertheless, the Bush administration reached an agreement with the Taiwanese government to extend to extend VRA for an extra two years. *Id.* Eventually, these VRAs have cultivated U.S. machine tools companies' international competitiveness and therefore have impeded these two countries' machine tools development in the U.S. market for seven years. *Id.*

[421] Id.

tools and deterred the price-sensitive U.S. consumers.[422]

Shortage of labor, costly domestic currency, and the possibility of re-imposing the VRA by the U.S. are the main threats to the development of Asian machine tool manufacturers. To alleviate these threats, Asian manufacturers should consider relocating their production to the NAFTA countries in order to regain their competitive position in the U.S. market. Mexico is a feasible investment destination for Asian machine tools makers because Mexico has abundant labor, a devaluated Mexican peso, and is free of export restraint to the U.S. market shielded by NAFTA.

Furthermore, Mexico also represents a promising market for Asian machine tool producers. Mexico's modernization in its economy and the establishment of NAFTA have increased new investments in various industries, such as automotive, autoparts and steel products, to expand their manufacture facilities and capacities.[423] This expansion of the Mexican manufacturing industry has stimulated a strong demand for machine tools, and such demand is expected to have an average 25 percent growth for the next three years.[424] To successfully use Mexico as a production base bound for the U.S. market, Asian machine tool makers need to carefully manage rules of origin under NAFTA, and utilize cheap Mexican labor imputs into their Mexican operations.

The above-mentioned analysis and suggestions intend to provide Asian enterprises with an alternative way of thinking when they formulate their Mexican operation strategies and use it as their North American production bases. It is understandable that many Asian enterprises are not the vanguards in the Mexican market to take the major shares of business benefits in this growing country. However, many opportunities still exist for Asian enterprises to secure a strong presence in the Mexican market, if they have the courage and wisdom to explore the market niches and successfully utilize their strengths in such niches.

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422 *See* Ben Shen, *Taiwan: Taipei Int'l Machine Tool Show—Increased Demand from European Buyers*, BUS. TAIWAN, Apr. 10, 1995.

423 *Mexico-Machine Tools Incl. Presses for Working Metals*, MKT. REP., Mar. 21, 1995, *available in* LEXIS, World Library, Market File.

424 *Id.*

VI. Conclusion

Undoubtedly, integration in the North American countries will have an impact on Asian countries. This integration also represents a significant challenge to their industries. Since the North American market represents a very important export destination of Asian products, enterprises from Asian countries must seriously consider establishing their production bases in Mexico in order to maintain their competitive positions in the NAFTA market.

There is also little doubt that Mexico's structural reforms have significantly contributed to the growth of the Mexican economy. Although some pitfalls such as labor practices and infrastructure exist in Mexico, the Mexican government's efforts in its macroeconomic adjustments and political reform will help Mexico improve its investment climate in the near future. In addition, Mexico's peso crisis has inevitably resulted in its economic stagnation in the near term, and unavoidably damaged investors' confidence in Mexico's investment climate. However, the sharp devaluation in the Mexican peso is not necessarily a negative to all investors. The peso crisis will certainly have a strong impact on investors involved in portfolio investment of Mexican government bonds. It also provides a positive influence for those investors involved in direct investments in Mexico. Because of the devaluated Mexican peso, investors can significantly reduce the production costs in Mexican operations, and therefore render their Mexican products more competitive in the global market.

The improvement in Mexico's foreign investment legal framework has facilitated foreign investors' bringing their capital and technologies to participate in Mexico's economic revitalization. However, the success in attracting the foreign investments and technologies may depend on enforcement of intellectual properties protection in Mexico. The Mexican government still needs to put great effort into enforcement issues in order to convince foreign investors that their technologies will truly be protected in Mexico. In addition, as tariff incentives in the maquiladora industry will be eliminated by NAFTA, the Mexican government needs to restructure the maquiladora industry form assembly-for-export industry to a full-scale manufacturing one, in order to ensure its continuation in providing economic benefits to both Mexico and foreign investors.

Because Mexico will benefit most from the North American integration, enterprises from Asia must make full use of Mexico's comparative advantages under NAFTA in order to sharpen their competitive position in the NAFTA market. However, they must pay attention to rules of origin, and carefully manage products which could serve as inputs into Mexican made final products bound for the North American market. Industries like automotive goods, textiles and apparels, computers, telecommunication equipment, and machine tools are suitable for Asian enterprises to build their North American production bases in Mexico. Nevertheless, they should fully utilize their strengths to build strategic alliances with other multinational corporations or local Mexican firms, and incorporate the strengths of the allied parties in order to quickly gain a strong position in the Mexican market.

At the 1994 Summit of Americas, the NAFTA partners invited Chile to join NAFTA, and also agreed to create a free-trade zone in the Americas by 2005. As the integration process continuously expands from North American countries to all the Western Hemisphere countries, Mexico cannot only be run by investors as a North American production base. Rather, investors should have a long-term view on running Mexico as a regional hub in the immense American market. It is true that Asian enterprises need to quickly establish bases in Mexico so that they not only can strengthen their competitiveness in the NAFTA market, but can also enjoy the major business benefits in the emerging Western Hemisphere Free Trade market.